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# Congress of the United States
## U.S. House of Representatives
## Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6315

To: Members, Committee on Small Business
From: Committee Staff
Date: January 10, 2014
Re: Full Committee Hearing: "*The Power of Connection: Peer-to-Peer Businesses*"

On Wednesday, January 15, 2014, at 1:00 pm in Room 2360 of the Rayburn House Office Building, the Committee on Small Business will meet to examine peer-to-peer businesses (P2P businesses). A P2P business creates a platform which acts as a conduit between buyers and sellers or entrepreneurs and consumers. The hearing will focus on the rise of this distinctive business model, its ability to create or advance the development of microentrepreneurs and small businesses, and the macroeconomic effects of P2P businesses.

## I. Introduction

For thousands of years, efforts have been made to bring buyers and sellers together. As far back as ancient Greece, merchants gathered in the Athenian agora where buyers came to make purchases.[1] Today, those same gathering places for merchants can be found in flea markets or shopping malls. However, these gathering places developed in an era long before the advent of Internet technology and advanced wireless mobile devices.

The Internet, smartphones, and global positioning satellite (GPS) locators enable buyers and sellers to connect in ways that would have astounded the ancient Greeks and even the car-conscious mid-20th century American consumer. Rather than inventing a new idea, P2P businesses utilize these technologies to create "new marketplaces to access familiar things in better ways."[2] This platform allows buyers and sellers to exchange goods with incredible efficiency; as the buyer no longer must make a trip to a store and the seller is able to obtain customers without setting up a traditional storefront thereby reducing barriers to entry. Twenty years ago, "the first generation of digital peer-to-peer platforms, such as eBay, began providing users with infrastructure to buy and sell from each other directly and circumvent traditional outlets."[3]

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[1] Donald Dixon, *Retailing in Classical Athens: Gleanings from Contemporary Literature and Art*, J. OF MACROMARKETING, Spring 1995, at 74.
[2] Emily Badger, *The Rise of Invisible Work*, THE ATLANTIC CITIES, Oct. 31, 2013, *available at* http://www.theatlanticcities.com/jobs-and-economy/2013/10/rise-invisible-work/7412/.
[3] John Hagel and John Seely Brown, *What the Sharing Economy Means for Business*, TECHONOMY, July 9, 2013, *available at* http://techonomy.com/2013/07/what-the-sharing-economy-means-for-business/.

Unlike the two millennia that separate the ancient agora from the 20th century flea market, technological advances occur so rapidly that first generation platforms, such as eBay, have themselves dramatically evolved. Today, P2P businesses have further evolved into a second phase that expands beyond the purchase and sale of goods into the service industry allowing consumers to find chefs or obtain car services. Therefore, utilizing these firms expands opportunities and options by creating access to assets that one may not have the need, ability, or desire to purchase.[4]

Therefore, two primary questions arise from growth of P2P businesses. First, what are the macroeconomic effects of these firms on the economy and entrepreneurship? Second, is the regulatory structure, which developed prior to the P2P business model appropriate for regulating P2P businesses?[5]

## II. Economic Effects of P2P Businesses

As mentioned above, P2P businesses appear to boost the ability to share assets that, absent the P2P businesses, would otherwise be unlikely to occur. This is often referred to as a "sharing economy." "Forbes estimates the revenue flowing through the share economy directly into people's wallets will surpass $3.5 billion [in 2013], with growth exceeding 25%. At that rate peer-to-peer sharing is moving from an income boost in a stagnant wage market into a disruptive economic force."[6] Further, P2P businesses are becoming more common, having received over $2 billion in venture capital funding in the last few years.[7]

P2P businesses alter the traditional method of calculating economic growth by creating a multiplier effect as new jobs are created within the P2P firms while also spurring new income, and in some cases full-time jobs, for those who utilize the platform to sell.[8] Due to this multiplier effect, various P2P companies are creating microentrepreneurs and nontraditional jobs typically not measured in the United States economy.[9]

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[4] GEORGIOS ZERVAS, ET. AL., THE RISE OF THE SHARING ECONOMY: ESTIMATING THE IMPACT OF AIRBNB ON THE HOTEL INDUSTRY 2 (2013), *available at* http://people.bu.edu/zg/publications/airbnb.pdf.

[5] For example, Airbnb enables homeowners to easily rent a room to travelers. However, the law surrounding such transactions emanated from the liabilities of inn-owners in England in the middle ages. It raises a question whether the same rules should apply to a homeowner renting a room to a stranger. *See* Frederick Jonassen, *The Law and the Host of the Canterbury Tales*, 43 J. MARSHALL L. REVIEW 51, 69-70 (2009) (discussing the genesis of innkeeper liability in 14th century England).

[6] Tomio Geron, *Airbnb and the Unstoppable Rise of the Share Economy*, FORBES, Jan. 23, 2013, *available at* http://www.forbes.com/sites/tomiogeron/2013/01/23/airbnb-and-the-unstoppable-rise-of-the-share-economy/.

[7] THE ALTIMETER GROUP, THE COLLABORATIVE ECONOMY 6 (2013), *available at* http://www.slideshare.net/Altimeter/the-collaborative-economy.

[8] Badger, *supra* note 2.

[9] *Id.*

According to various reports, this translates into significant monetary gains for an entrepreneur on the P2P platform.[10] For example, Etsy, a popular P2P marketplace for homemade goods and crafts, has over a million sellers worldwide, and in 2012 these sellers generated $895 million sales.[11] A recent survey of Etsy sellers in the United States noted that the majority of these individuals had a median household income 10.2 percent lower than the national average, but sellers utilize their supplemental income, contributing on average 7.6 percent to household income.[12] Thus, Etsy enables individuals, who otherwise might not be entrepreneurs, to create businesses that supplement their income from other sources. Ultimately, this will enable Etsy sellers to move up the economic ladder.

Additionally, P2P businesses appear to have a significant impact on the local economy itself, and individuals who utilize P2P tend to spend or reinvest in the local economy rather than redistributing the funds elsewhere. For example, Airbnb reported that in 2012 in New York City alone, the economic impact of 416,000 visitors utilizing their platform was $632 million.[13] Notably, the report stated that 57 percent of spending by Airbnb visitors occurred within the same neighborhood of their lodging rather than elsewhere in the city.[14]

Etsy, like other P2P businesses, provides an individual the opportunity to measure potential success prior to leaving their job or investing all their savings into a new business venture. As a result, P2P business platforms reduce barriers to entry and exit into the marketplace.[15] Arguably, if one is highly successful, ultimately a new business venture will lead to more jobs and economic growth. Conversely, the P2P experience allows an individual who is unsuccessful to fail without the same risks found in traditional small firms.

The P2P business model appears to be significantly altering economic trends. However, a true estimate of the macroeconomic effects of P2P businesses is difficult to ascertain since the vast majority of these businesses are of recent vintage. Given the fact that half of all new enterprises fail,[16] the story of the impact of these businesses on the American economy has yet to be written.

## III. Economic Disruption

[10] Please note that these reports are often produced by the companies themselves as they are the ones with access to information regarding the various uses of their platform.

[11] ETSY, REDEFINING ENTREPRENEURSHIP: ETSY SELLERS' ECONOMIC IMPACT 2 (2013), *available at* https://www.etsy.com/blog/news/files/2013/11/Etsy_Redefining-Entrepreneurship_November-2013.pdf.

[12] *Id. at* 2, 8.

[13] AIRBNB, THE AIRBNB COMMUNITY'S ECONOMIC IMPACT ON NEW YORK CITY 3 (2013), *available at* http://blog.airbnb.com/wp-content/uploads/Airbnb-economic-impact-study-New-York-City.pdf.

[14] *Id.* at 6.

[15] Badger, *supra* note 2.

[16] The Small Business Administration's Office of Advocacy notes that half of all new establishments fail in the first five years. OFFICE OF ADVOCACY, SMALL BUSINESS ADMINISTRATION, FREQUENTLY ASKED QUESTIONS 3 (2012), *available at* http://www.sba.gov/sites/default/files/FAQ_Sept_2012.pdf.

Despite the recency of the P2P business model, particularly the second generation which includes the service industry, it demonstrates an axiomatic principle of economics – that technological changes result in a more efficient allocation of resources which in turn results in new consumption leading to new production.[17] New technologies, while increasing consumption and production of goods or services, also may have a disruptive effect on existing businesses in a same or similar industry.[18] P2P businesses enable new ways of obtaining goods and services; be it purchasing something using an Internet portal or arranging a car-for-hire by clicking upon a mobile device. These changes based on technological advancements enable non-traditional entrants into businesses that historically required construction of a storefront or driving up and down streets looking for potential fares.

By itself, adoption of new technologies that disrupt existing industries is not a sole condition for success nor does it necessarily dispose of existing industries. Technology that may improve the efficiency of a firm's production may be of little value if consumers find its utilization inefficient. However, in today's economy, P2P businesses appear to be popping up in a variety of industries demonstrating that the efficiency provided by P2P businesses is beneficial to consumers. Thus, "if your business relies on a model of consumption that is inefficient for your consumers, chances are that there's already a new sharing economy marketplace that is looking to streamline it for them"[19]

## IV. New Regulatory Challenges Due to Innovation

The growth of economic disruption due to P2P businesses also may have a ripple effect creating regulatory disruption. With P2P business lowering barriers to entry, "the regulatory microscope has started to focus in on this new [Internet] economy – examining companies with dictums ranging from New York's hotel, rental, and taxicab laws to California Money Transmission Act."[20] While the regulatory hurdles are currently occurring at a state and local level, it is important to understand the challenges in attempting to apply regulations designed for traditional firms to business arising out of the P2P business model.

The need to regulate business generally comes from a concern for safety and protection.[21] However, P2P businesses generally would not be viable business models without some level of internal security. For example, the first generation of P2P

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[17] Badger, *supra* note 2.

[18] For example, primarily due to Amazon's presence as a bookseller the number of independent bookstores in the United States has declined from 4,000 to 1,900 in the past two decades. Steve Wasserman, *The Amazon Effect*, THE NATION, May 29, 2012, *available at* www.thenation.com/article/168125/amazon-effect.

[19] Posting of Arun Sundararajan to HBR Blog Network, *From Zipcar to the Sharing Economy*, *available at* http://blogs.hbr.org/2013/01/from-zipcar-to-the-sharing-eco/ (Jan. 3, 2013, 11:43 EST).

[20] Arun Sundararajan, *Why the Government Doesn't Need to Regulate the Sharing Economy*, WIRED, Oct. 22, 2013, *available at* http://www.wired.com/opinion/2012/10/from-airbnb-to-coursera-why-the-government-shouldnt-regulate-the-sharing-economy/.

[21] *Id.*

businesses, such as eBay, struggled with ways to ensure that its sellers sent the goods as advertised or did not misuse payment information. Ultimately, eBay self-regulated its site for its own success, as well as the success of its sellers.

This second generation of P2P businesses, though, presents different issues, as the companies do not purely sell an item but rather may share an asset for convenience, such as renting a room in a house or allowing someone to use a car. Previous regulations designed for a traditional company may not fit this new model of asset sharing as a business.

This concern recently played out in the transportation industry in California, where ride-sharing platforms such as UberX, Lyft, and Sidecar were competing with licensed taxi cabs and car services. Thus, these new ride-sharing platforms were being subjected to regulations intended for licensees that operated almost as common carriers. In August 2012, the California Public Utilities Commission (CPUC) issued cease and desist letters to various ride-sharing platforms claiming that under California state law the businesses were "charter-party carriers" and required a specialized permit to operate.[22]

Following this, the CPUC and ride-sharing companies worked together in order to recognize the differences between the two types of business models. In September 2013, California opted to designate these P2P businesses specializing in transportation as a new type of firm called "transportation network companies" (TNCs) and subjected them to their own regulations, significantly different than those applied to the existing charter party carriers. Under these new regulations, TNCs must "have a minimum of $1 million in insurance, vehicle inspections, driver training programs, a 'zero tolerance' policy on drugs and alcohol, and criminal background checks."[23] In creating these regulations, California became the first state to affirmatively legalize these types of P2P transportation companies.[24]

A similar clash between pre-P2P businesses and P2P platforms is playing out in the New York City lodging industry. Under a 2010 New York state law individuals may

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[22] *See* Michael Cabanatuan, *Putting Brakes on Ride-Sharing Apps*, SF GATE, July 3, 2013, *available at* http://www.sfgate.com/bayarea/article/Putting-brakes-on-ride-sharing-apps-3927193.php; (noting that "charter-party carrier permit make sure drivers are properly licensed, screened and insured to carry commercial passengers"); *see also* Tomio Geron, *Ride-Sharing Startups Get California Cease-And-Desist Letters*, FORBES, Oct. 8, 2013, *available at* http://www.forbes.com/sites/tomiogeron/2012/10/08/ride-sharing-startups-get-california-cease-and-desist-letters/ (noting that charter-party permits are required of airport vans, limousines, and similar carriers in California).

[23] Tomio Geron, *California Becomes First State to Regulate Ridesharing Services Lyft, Sidecar, UberX*, FORBES, Sept. 19, 2013, *available at* http://www.forbes.com/sites/tomiogeron/2013/09/19/california-becomes-first-state-to-regulate-ridesharing-services-lyft-sidecar-uberx/ [hereinafter Geron, First State]; *see also* CALIFORNIA PUBLIC UTILITIES COMMISSION, CPUC ESTABLISHES RULES FOR TRANSPORTATION NETWORK COMPANIES (2013), *available at* http://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M077/K132/77132276.PDF.

[24] Geron, First State, *supra* note 23. Please note the primary difference in P2P transportation companies from a traditional carrier, such as a taxi cab, is the method of procuring the ride is prearranged and done through an app. Thus when the driver picks up the passenger they already know the destination. Further, the driver always using their personal vehicle.

not rent an apartment for less than 30 days if a permanent resident of the apartment is not present.[25] As a result, in early October, New York State's Attorney General Eric Schneiderman issued a subpoena to Airbnb[26] requesting records of their hosts in New York.[27] Based on information provided by Airbnb under the subpoena, New York's Attorney General's Office claims that "the top 40 Airbnb hosts in New York have each grossed at least $400,000 over the past three years, a collective total of over $35 million. The top 100 hosts in that time period have grossed $54 million."[28]

Given these recent developments, two possibilities now exist in New York. First, the law will be rewritten, as it was in California for the transportation industry, to accommodate a new business model. Alternatively Airbnb and similar P2P platforms, who view themselves as substantially different from those the laws means to target, will need to alter their business model to comply with existing New York law emanating from innkeeper liability of medieval England. However, based on prior discussion of economic disruption, it would appear that existing regulatory structure should not be used to erect barriers simply to protect pre-existing businesses as the market should dictate which model should expand, contract, or even reach some type of natural coexistence.

## V. Conclusion

While the economic effects are currently debated, it appears clear that the P2P business model is shifting parts of the economy while reducing barriers to entry into the marketplace for individuals. In a volatile economy, where unemployment remains high P2P businesses are further adding individuals by generating a supplemental or even primary income source. As the various legal and regulatory concerns noted above demonstrate, at the state and local level, P2P businesses are already forcing jurisdictions to consider the impact of these firms on existing industries. The challenges in operating a successful P2P business are becoming unique and have impacts on both the P2P itself as well as those utilizing the platform to insure compliance with new rules. This raises the question of whether regulations will continue to be altered or re-aligned to fit the P2P model, or if existing industries regulations will narrow the abilities of innovative platforms by forcing them to fit a mold which may not properly reflect their business models.

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[25] Broadly this law is meant to ensure that hotel pay a specialized tax that an individual would not be subject to. James Surowiecki, *Airbnb's New York Problem*, THE NEW YORKER, Oct. 8, 2013, *available at* http://www.newyorker.com/online/blogs/currency/2013/10/airbnbs-new-york-problem.html.

[26] According to Airbnb's website, "Airbnb is a community marketplace where guests can book spaces from hosts, connecting people who have space to spare with those who are looking for a place to stay." https://www.airbnb.com/help/question/1.

[27] Brian R. Fitzgerald and Erica Orden, *Airbnb Gets Subpoena for User Data in New York*, WALL ST. J., Oct. 7, 2013, *available at* http://online.wsj.com/news/articles/SB10001424052702304441404579121864021592746.

[28] Elizabeth A. Harris, *The Airbnb Economy in New York: Lucrative but Often Illegal*, N.Y. Times, Nov. 4, 2013, *available at* http://www.nytimes.com/2013/11/05/nyregion/the-airbnb-economy-in-new-york-lucrative-but-often-unlawful.html?_r=0.