Democratizing Disruption:

The spread of Sharing Economy models in "traditional" business

RISK + INNOVATION | PART 9 IN A SERIES

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INTRODUCTION

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When the technological advances of geo-localization, smart phones and software applications that connect supply and demand combine, they create the conditions of the Sharing Economy. The net effect produces new markets for goods or services or can make existing markets run more efficiently.

Geo-localization makes the flex in supply and demand visible, while applications make this insight actionable by connecting both sides digitally. Valuable assets, underused for lack of opportunity for anyone but their owners to exploit, match up with willing "renters." The allure of services can be assessed based on convenience or the need for proximity — for example, lawn care vs. graphic design, widening markets for services that can be provided remotely. Supply-chain logistics, which spans goods and services, quickly saw the potential in geo-localization. It decreases reliance on a central dispatch or hub-and-spoke model and enables route optimization[1].

Less novel in the information age, but as critical to facilitating market efficiency, software applications readily regroup data, addressing information asymmetry between buyers and sellers.

The spread of the technologies involved makes the number and variations of use cases seem infinite. There are as many ways of categorizing Sharing Economy models as there are data visualization methods. But we find a simple and convenient split that mirrors the insurance world: 1) models that optimize the value of tangible assets (property) and 2) those that engage labor and care through the performance of a service ("casualty" or liability).

1 Dispatch efficiency is both based on and limited by a radius from the center. The smaller the distance from the center, the more efficiently the system functions. But as the radius gets larger, more distances lie in the outer circles around the hub and require more circuitous routes to get to and from different points.

USE CASES, ADVANTAGES AND CHALLENGES OF SHARING ECONOMY MODELS

SERVICES

When it comes to providing services, the Sharing Economy changes how people see the labor supply[2]. The ability to connect digitally increases the pool of willing and able suppliers. It translates into quick assembly of the right amount of resources to perform almost any task, including as the need/demand for that task arises. The flex in resources can apply to crowd-sourcing artistic or creative endeavors (like NikeID's customized shoes), piloting a new offering through a limited edition (i.e., leveraging localized supply-chain inputs), or expanding a customer base by bringing the product to the customer.

Restaurants have acted on this last feature. Delivering just beyond the radius that diners typically drive acquaints new customers with the restaurant. New customers might either choose to make the trip, depending on other factors like quality and value; or they might opt more often to have their meal brought to them. What's changed from traditional pizza delivery? Instead of hiring enough deliverers to cover an area, the restaurant is now a member of a delivery network. With services like GrubHub, DoorDash and Uber Eats thriving in hundreds of cities, the restaurant can rely on the "most available" driver to come to it, pick-up an order and deliver.

On the labor supply side, the model offers corresponding advantages: both individual and enterprise service providers can cancel out the impact of distance either because the service can be provided remotely or because willing customers have been identified locally. They can also better manage the sequence and duration of tasks or projects. For example, if a residential contractor with three roofers, three carpenters and five painters has its roofers and carpenters engaged at full capacity, a digital platform like Thumbtack or TaskRabbit can facilitate advertising, prospecting and customer contact for painting jobs. Since the platform can also regroup information about the size of the tasks, the company can optimize deployment of its five painters (e.g., maximize per job profitability based on labor cost).

For individual service providers, the model's advantage translates into flexibility: flexibility as to task, as to platform or customer, and as to time-availability. While the need for secondary income is an economic reality among many who offer services through digital platforms[3,4,5], the ability to earn income from work in smaller, broken up periods can alleviate some of the strain of rigid shifts. The variety of demand for services and the time in which to perform them is a noteworthy advance.

But disparity (actual or apparent) in the flow of benefits from "on-demand" capabilities may blur lines when it comes to worker status. For the end-customer, few non technology-enabled services provide comparable convenience. Likewise, for the platform "making available" on-demand services, reward exceeds effort, given the cost of app licensing. The end service-provider, however, carries the responsibility for the profitability of the transaction – without necessarily having a full say in the pricing or the methods of performance. This happens less when contracting and performance of services take place over time rather than instantaneously, bolstering the independent contractor relationship that's meant to exist between the platform and the service provider. Indeed, while terms of service and user agreements by and large form this private, contractual relationship, the contracts themselves function within the "floors and ceilings" of public law, like employment protections.

2 This labor "revolution" may have largely contributed to the Sharing Economy also being referred to as the "disruptive economy." Technology permitted a rapid influx of individuals ready to perform relatively simple services on an "ad hoc" basis. They effectively began competing with established businesses – sometimes without the licenses incumbents had invested in.

3 Farrell, Diana, et al. "The Online Platform Economy in 2018: Drivers, Workers, Sellers, and Lessors." JP Morgan Chase & Co. Institute.

4 "Contingent and Alternative Employment Arrangements - May 2017." June 7, 2018, Bureau of Labor Statistics News Release and Supplement https://www.bls.gov/news.release/pdf/conemp.pdf, https://www.bls.gov/cps/electronically-mediated-employment.htm#highlights

5 "Insuring the Sharing Economy." AIG & Marsh. https://www.aig.com/content/dam/aig/america-canada/us/documents/insights/aig-insuring-the-sharing-economy.pdf

ASSETS

> *"If it appreciates, buy it. If it depreciates, rent it."*
>
> – John Paul Getty

Whether technology can fully convert assets that depreciate into ones that appreciate remains to be seen. But in the meantime, it can enhance the use of either class of asset. For those that tend to appreciate, like real estate, technology can unlock additional value by enabling vacancy times to be divided into more flexible rental periods. Spare bedrooms and meeting rooms can be made available for minimal durations because a market of willing users can be identified in real time. The convenience of this flexibility can also be built into the rental price. For assets that depreciate, like vehicles or equipment, being able to rent them during the owner's downtime can help offset the depreciation expense. And once again, technology facilitates the market.

Considerations around depreciation also open up some interesting use cases, spurring questions about the value and "true" cost of asset ownership. Conventional wisdom rues a new car's loss of value the moment it's driven off the lot: even if an owner needs and uses a car every day, its utility comes at a higher cost in the early years. Business models like vehicle subscription address this very issue by giving undiminished access to the needed asset, while reducing cost elements like sales tax, financing and depreciation in the early years of ownership[6]. Under these models, maintenance remains the responsibility of the owner – the OEM or the dealership – providing convenience to the renter/subscriber and greater control over the asset's condition.

Ensuring an asset's upkeep is critical to its retaining value, no matter its owner's chosen use for it. Since the standard of care for a similar asset can be different among owners, multiplying the number of users of one asset will change how it is maintained. This may be one of the disadvantages of "sharing." In a traditional leasing arrangement, the owner knows the one renter and may impose and enforce restrictions on the asset's use. By definition, the sharing economy implies multiple renters, complicating the owner's control over the conditions of use among different renters, with each of them using the asset with varying degrees of care.

6 Wood, DoShik. "OEMs' Subscription Plans Could Revolutionize Auto Industry." Wards Auto. June 12, 2018. https://www.wardsauto.com/industry-voices/oems-subscription-plans-could-revolutionize-auto-industry

INSURANCE CONSIDERATIONS

The Sharing Economy blurs the lines between use and ownership. When that happens, the model can disrupt the traditional relationships on which insurance is based – those that pre-defined how risk was to be allocated, whether by agreement or otherwise. Typically, both the right and obligation to insure falls to the owner or operator of an asset, or to the person undertaking an activity that requires a duty of care to others. In the case of home or boat sharing, available assets don't belong to the digital platform. But advertising of the homes and boats, offer and acceptance for their rental, and exchange of payment can all take place there. Does that imply an obligation by the platform to purchase insurance for damage to the leased assets? And would it have a sufficient insurable interest to do so?

When it comes to services, two main questions arise. First, does enabling individuals to be paid for a task performed through the platform substitute the platform for an employer? Secondly, to what extent can or should the platform be responsible for the actions of its members in relationship with one another? Conversely, the platform may want to carry insurance for a variety of reasons, but may wonder whether doing so could undermine its business model. For example, if a platform insures its liability for activities that takes place through it – be it event planning, dog walking or window replacement – does the existence of coverage infer the platform's responsibility for the service providers' work as if they were agents or employees?

While having different views on who should bear the responsibility of insuring, recent surveys suggest that there would be greater participation by both types of users –"hosts," "guests", riders, drivers — if insurance were readily available[7]. But risk (re)allocation isn't the only factor determining where and how insurance fits in. How confidence is measured and maintained in the market must also be understood. So must the ways that online interaction can lead to disputes and the means to defuse those disputes. To the extent that insurance is seen as a vector to build trust, this may be putting the cart before the horse. Insurance has traditionally empowered enterprise by assuming the risk of catastrophic loss through risk-spreading. But this has been possible because of the understanding of risk inherent in the activity, how it is allocated among participants and the development of practices by those bearing responsibility to mitigate it.

> Does enabling individuals to be paid for a task performed through the platform substitute the platform for an employer?

> To what extent can or should the platform be responsible for the actions of its members in relationship with one another?

7 "Sharing risks, sharing rewards: who should bear the risk in the sharing economy?" Lloyd's Innovation Report 2018. https://www.lloyds.com/news-and-risk-insight/risk-reports/library/technology/sharing-risks-sharing-rewards

HYBRIDIZATION – TRADITIONAL RELATIONSHIPS, SHARING ECONOMY BENEFITS

"Membership has its privileges" – American Express ad slogan ca. 1995

Those who remember American Express' slogan might be impressed with the stickiness of the branding – and know how valuable that can be. The slogan adapts itself well to those Sharing Economy models that combine the benefits of brand recognition and favored admittance. Indeed, "hybrid" models adopt principles like "access over ownership" while acknowledging that ownership retains certain advantages, especially when a brand has become a household name. To both leverage and protect its name recognition[8], a company may choose to "manage" or keep some control over an operation as it would under traditional models. This applies to both assets and services. In the case of assets – for example, Mercedes-Benz Collection's subscription service – a car's reliability and cleanliness can reflect on the OEM's brand, making it attractive to the OEM to build in maintenance into its offering. In the case of services, and similar to many decisions about outsourcing, the question is not only who can perform a task more efficiently. How closely the task relates to the core function of the business also determines the desirability of greater exercise of control over quality and consistency in performance of those tasks. Finally, while insurance considerations may not drive a decision to hybridize and integrate a sharing economy model, hybrid models tend to build in greater overall risk control, skirting some of the challenges of the original concept. For example, a hospitality chain with a network of unique locations may elect not only to check the properties for the "finishing touches" that showcase its brand, it may also ensure accessibility standards.

8 Brand and reputation can be seen as two facets of marketplace recognition: the power of attraction of a company's name and the risks that go with the vast expectations of a customer base when it comes to the company's prestige.

CONCLUSION

More than a bandwagon to jump on, the combined technologies that build the Sharing Economy represent real tools and models for companies to add value to their customers. Rather than "predict" in a binary way whether or not the new models will replace the old, both will likely mix, influence one another and evolve within different sectors and industries. Meanwhile, the roles and responsibilities of the actors within these ecosystems and value chains will stabilize – that is, they will reflect established relationships (i.e., contractor-subcontractor, employer-employee, or principal-agent). Understanding the relationships means understanding the risk allocation between them in their transactions. And this means knowing how to insure the risk.

In closing, we offer some ways for companies to look at their businesses through the lens of Sharing Economy models and explore potential use cases. The questions open onto some of the ways more "traditional" business can benefit from the innovation of these new models. They also anticipate some of the risk allocation and insurance questions that can be met along the way – all of which AIG is always ready to discuss with its clients and partners.

APPENDIX: QUESTIONS TO GUIDE USE CASE EVALUATION

<table>
<tr><th>TOPIC</th><th>SERVICE-RELATED OFFERINGS</th><th>ASSET-RELATED OFFERINGS</th></tr>
<tr><td>Context of existing business</td><td colspan="2">What does my company offer in terms of both products and services?
Who makes up my customer base, and how dependent am I on geographic proximity to keep or build that base?
How do my customers interact – or how might they like to do so - with my company? How can I make my offerings more relevant and tailored to them?
Are there any other customer engagement initiatives going on in my company?</td></tr>
<tr><td>Use case evaluation –general</td><td colspan="2">To what degree are my offerings interconnected (i.e., equipment + maintenance or equipment + warranty)?
Are related offerings sold or distributed in the same way?
Do any offerings depend on being renewed or updated to remain relevant to my customers?
Is there value to my customers in making my offerings accessible in a different way (i.e., subscribing to instead of leasing or owning)?</td></tr>
<tr><td>Use case evaluation –specific</td><td>Is my company looking to offer a new services business?
Does the new service relate to entry into a completely new market?
Does the new service relate to my company's expansion of expertise?
Are there perceived benefits to "testing" the new service or launching it on a smaller scale?
How close to my company's core business are these new services?
How do these new services differ from service that my company would normally outsource to a third-party vendor?</td><td>Is the initial cost of the assets my company sells a barrier to expanding my market?
Are there any cost elements that increase or decrease over time?
To what extent do financial products or lending options sufficiently address initial cost barriers?
Does the capital intensiveness of my company's business preserve a scale advantage over competitors?
To what degree is my product sensitive to factors, like demographic trends or rapid technological development, that would make ownership less convenient or desirable?
Can any savings be gained by decentralizing distribution of my company's product, vs. maintaining many distribution centers?</td></tr>
<tr><td>Considerations around risk and insurance -general</td><td colspan="2">To what degree is my company's brand relied on for the success of the new offering? To what degree could customer dissatisfaction with the new offering expose my company or its brand to risk?
Is dissatisfaction from customers easily detected, monitored and remedied?
Does my offering involve anything that could become contentious if it did not go as planned, especially if it is unclear who is responsible?
To what degree should I expect customers of this new offering to turn to my company if something goes wrong or unexpectedly?
Based on my expectations for suppliers and my customers' expectations for the quality of any offering, how will my company intervene between suppliers and end customers if something goes unexpectedly?
To what degree is it advantageous for my company to retain control of its offering? How much control over the quality of my product or service needs to be retained, both for its success and to mitigate exposure of my company's brand?</td></tr>
</table>

TOPIC	SERVICE-RELATED OFFERINGS	ASSET-RELATED OFFERINGS
Insurance-related considerations -specific	• To the extent my company is looking for service providers to supply the new offering, does my company have employees with similar tasks or responsibilities? • Does the new offering depend on the service being performed on-demand or later in time? • To what extent is the offering new or separate from my company's core business? • Will the new offering need to rely on the service providers being exclusive to my company? • Are any of the service providers undertaking activities for which a professional license or certification is required?	• Who will be using my product through "access"? • Who will be responsible for the upkeep of the asset, or for making sure that it will be in suitable condition for the next user? • Will users return my asset to a central location when the term of use is done, or will the next user access the asset from the prior one? • Do the users of my product need a license or certification to use or operate the asset?

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