



Airbnb in 2016: A Business Model for the Sharing Economy

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“In the future, you will own what [assets] you want responsibility for,” commented CEO and founder of Airbnb, Brian Chesky, concerning the sharing economy in an interview with Trevor Noah on *The Daily Show* in March 2016.¹ Airbnb was founded in 2008 when Chesky and a friend decided to rent their apartment to guests for a local convention. To accommodate the guests, they used air mattresses and referred to it as the “Air Bed & Breakfast.” It was that weekend when the idea—and the potential viability—of a peer-to-peer room-sharing business model was born. While not yet a publicly traded company in 2016, Airbnb had seen immense growth and success in its eight-year existence. The room-sharing company had expanded to over 190 countries with more than 2 million listed properties, and had an estimated valuation of \$30 billion. Airbnb seemed poised to revolutionize the hotel and tourism industry through its business model that allowed hosts to offer spare rooms or entire homes to potential guests, in a peer-reviewed digital marketplace.

This business model’s success was leveraging what had become known as the sharing economy. Yet, with its growth and usage of a new business model, Airbnb was now faced with resistance, as owners and operators of hotels, motels, and bed and breakfasts were crying fowl. While these traditional brick-and-mortar establishments were subject to regulations and taxation, Airbnb hosts were able to circumvent and avoid such liabilities due to participation in Airbnb’s digital marketplace. In other instances, Airbnb hosts had encountered legal issues due to city and state ordinances governing hotels and apartment leases. Stories of guests who would

not leave and hosts needing to evict them because city regulations deemed the guests apartment leases were beginning to make headlines.

As local city and government officials across the United States, and in countries like Japan, debated regulations concerning Airbnb, Brian Chesky needed to manage this new business model, which had led to phenomenal success within a new, sharing economy.

OVERVIEW OF ACCOMMODATION MARKET

Hotels, motels, and bed and breakfasts competed within the larger, tourist accommodation market. All businesses operating within this sector offered lodging, but were differentiated by their amenities. Hotels and motels were defined as larger facilities accommodating guests in single or multiple rooms. Motels specifically offered smaller rooms with direct parking lot access from the unit and amenities such as laundry facilities to travelers who were using their own transportation. Motels might also be located closer to roadways, providing guests quicker and more convenient access to highways. It was also not uncommon for motel guests to segment a longer road trip as they commuted to a vacation destination, thereby potentially staying at several motels during their travel. Hotels, however, invested heavily in additional amenities as they competed for all segments of travelers. Amenities, including on-premise spa facilities and fine dining, were often offered by the hotel. Further, properties offering spectacular views, bolstering a hotel

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EXHIBIT 1 Major Market Segments for Hotels/Motels and Bed and Breakfast/Hostels Sectors, 2015

Market Segment	B&Bs	Hotels
Recreation	80%*	70%**
Business	12%	18%
Other, including meetings	8%	12%
Total	100%	100%

*The bed and breakfast market is primarily domestic.

**Includes both domestic and international travelers. Approximately 20 percent is associated with international travelers.

Source: www.ibisworld.com.

as the vacation destination, may contribute to significant operating costs. In total, wages, property, and utilities, as well as purchases such as food, account for 61 percent of the industry's total costs (see Exhibit 1).²

Bed and breakfasts, however, were much smaller, usually where owner-operators offered a couple of rooms within their own home to accommodate guests. The environment of the bed and breakfast—one of a cozy, home-like ambience—was what the guest desired when booking a room. Contrasted with the hotel or motel, a bed and breakfast offered a more personalized, yet quieter atmosphere. Further, many bed and breakfast establishments were in rural areas where the investment to establish a larger hotel may have been cost prohibitive, yet the location itself could be an attraction to tourists. In these areas individuals invested in a home and property, possibly with a historical background, to offer a bed and breakfast with great allure and ambience for the guests' experiences. Thus, the bed and breakfast competed through offering an ambience associated with a more rural, slower pace through which travelers connected with their hosts and the surrounding community. A comparison of the primary market segments of bed and breakfasts and hotels in 2015 is presented in Exhibit 2.

While differing in size and target consumer, all hotels, motels, and bed and breakfasts were subject to city, state, and federal regulations. These regulations covered areas such as the physical property

EXHIBIT 2 Hotel, Motel, and Bed and Breakfast Industry Costs as Percentage of Revenue, 2015

Costs	Hotels/Motels	Bed and Breakfasts
Wages	26%	23%
Purchases	27%	21%
Depreciation	10%	9%
Marketing	2%	2%
Rent and Utilities	8%	11%
Other	12%	16%

Source: www.ibisworld.com, rounded to nearest percent.

and food safety, access for persons with disabilities, and even alcohol distribution. Owners and operators were subject to paying fees for different licenses to operate. Due to operating as a business, these properties and the associated revenues were also subject to state and federal taxation.

A BUSINESS MODEL FOR THE SHARING ECONOMY

Startup companies have been functioning in a space commonly referred to as the "sharing economy" for several years. According to Chesky, the previous model for the economy was based on ownership.³ Thus, operating a business first necessitated ownership of the assets required to do business. Any spare capacity the business faced—either within production or service—was a direct result of the purchase of hard assets in the daily activity of conducting business.

Airbnb and other similar companies, however, operated through offering a technological platform, where individuals with spare capacity could offer their services. By leveraging the ubiquitous usage of smartphones and the continual decrease in technology costs, these companies provided a platform for individuals to instantly share a number of resources. Thus, a homeowner with a spare room could offer it for rent. Or, the car owner with spare time could offer [his or her] services a couple of nights a week

as a taxi service. The individual simply signed up through the platform and began to offer the service or resource. The company then charged a small transaction fee as the service between both users was facilitated.

Within its business model, Airbnb received a percentage of what the host received for the room. For Airbnb, its revenues were decoupled from the considerable operating expenses of traditional lodging establishments and provided it with significantly smaller operating costs than hotels, motels, and bed and breakfasts. Rather than expenses related to owning and operating real estate properties, Airbnb's expenses were that of a technology company. Airbnb's business model in 2016, therefore, was based on the revenue-cost-margin structure of an online marketplace, rather than a lodging establishment, with an estimated 11 percent fee per room stay.⁴ The company's business model that generated fees from room bookings had allowed its revenues to increase from an estimated \$6 million in 2010 to a projected \$1.2 billion by 2017 (see Exhibit 3).

A Change in the Consumer Experience and Rate

Airbnb, however, was not just leveraging technology. It was also leveraging the change in how the current consumer interacted with businesses. In conjunction with this change seemed to be how the consumer had deemphasized ownership. Instead of focusing on ownership, consumers seemed to prefer sharing or renting. Other startup companies have been targeting these segments through subscription-based services and on-demand help. From luxury watches to clothing, experiencing—and not owning—assets seemed to be on the rise. Citing a more experiential-based economy, Chesky believed Airbnb guests desired a community and a

closer relationship with the host—and there seemed to be support for this assertion.⁵ A recent Gold Sachs study showed that once someone used Airbnb, their preference for a traditional accommodation was greatly reduced.⁶ The appeal of the company's value proposition with customers had allowed Airbnb to readily raise capital to support its growth, including an \$850 million cash infusion in 2016 that raised its estimated valuation to \$30 billion. A comparison of Airbnb's market capitalization to the world's largest hoteliers is presented in Exhibit 4.

Recognizing this shift in consumer preference, traditional brick-and-mortar operators were responding. Hilton was considering offering a hosted option to travelers.⁷ Other entrepreneurs were structuring urban properties to specifically leverage Airbnb's platform and offer rooms only to Airbnb users, such as in Japan⁸ where rent and hotel were extremely high.

To govern the community of hosts and guests, Airbnb had instituted a rating system. Popularized by companies such as Amazon, eBay, and peer-to-peer ratings helped police quality. Airbnb guests and hosts rated each other in Airbnb

EXHIBIT 4 Market Capitalization Comparison, August 2016 (in billion \$)

Competitor	Market Capitalization
Airbnb	\$30.0
Hilton Worldwide Holdings	22.8
Marriott International Inc.	\$17.5
Intercontinental Hotels Group	9.9

Sources: "Airbnb Valued at \$30 Billion in \$850 Million Capital Raise," *Fortune*, August 6, 2016; finance.yahoo.com.

EXHIBIT 3 Airbnb Estimated Revenue and Bookings Growth, 2010-2017 (in millions)

Costs	2010	2011	2012	2013	2014	2015	2016
Estimated Revenue	\$6	\$44	\$132	\$264	\$436	\$675	\$945
Estimated Bookings Growth	273%	666%	200%	100%	65%	55%	40%

Source: Ali Rafat, "Airbnb's Revenues Will Cross Half Billion Mark in 2015," *Analysts Estimate*, March 25, 2015, skift.com/2015/03/airbnbs-revenues-will-cross-half-billion-mark-in-2015-analysts-estimate/.

approach incentivized hosts to provide quality service, while encouraging guests to leave a property as they found it. Further, the peer-to-peer rating system greatly minimized the otherwise significant task and expense of Airbnb employees assessing and rating each individual participant within Airbnb's platform.

Not Playing by the Same Rules

Local and global businesses criticized Airbnb for what they claimed were unfair business practices and lobbied lawmakers to force the company to comply with lodging regulations. These concerns illuminated how due to its business model, Airbnb and its users seemed to not need to abide by these same regulations. This could have been concerning on many levels. For the guest, regulations exist for protection from unsafe accommodations. Fire codes and occupation limits all exist to prevent injury and death. Laws also exist to prevent discrimination, as traditional brick-and-mortar accommodations are barred from not providing lodging to guests based on race and other protected classes. But, there seemed to be evidence that Airbnb guests had faced such discrimination from hosts.⁹

Hosts might also expose themselves to legal and financial problems from accommodating guests. There had been stories of hosts needing to evict guests who would not leave, and due to local ordinances the guests were actually protected as apartment leasees. Other stories highlighted rooms and homes being damaged by huge parties given by Airbnb guests. Hosts might also be exposed to liability issues in the instance of an injury or even a death of a guest.

Finally, there were accusations of businesses using Airbnb's marketplace to own and operate accommodations without obtaining the proper licenses. These locations appeared to be individuals on the surface, but were actually businesses. And, because of Airbnb's platform, these pseudo-businesses could operate and generate revenue without meeting regulations or claiming revenues for taxation.

"We Wish to Be Regulated, This Would Legitimize Us"

Recognizing that countries and local municipalities were responding to the local business owner and their constituents' concerns, Chesky and Airbnb have focused on mobilizing and advocating for consumers and business owners who utilize the app. Airbnb's website provided support for guests and hosts who wished to advocate for the site. A focal point of the advocacy emphasized how those particularly hit hard at the height of the recession relied on Airbnb to establish a revenue stream, and prevent the inevitable foreclosure and bankruptcy.

Yet, traditional brick-and-mortar establishments subject to taxation and regulations have continued to put pressure on government officials to level the playing field. "We wish to be regulated, this would legitimize us," Chesky remarked to Noah in the same interview on *The Daily Show*.¹⁰ Proceeding forward and possibly preparing for a future public offering, Chesky would need to manage how their progressive business model—while fit for the new, global sharing economy—may not fit older, local regulations.

ENDNOTES

¹ Interview with Airbnb founder and CEO, Brian Chesky, *The Daily Show with Trevor Noah*, Comedy Central, February 24, 2016.

² IBISWorld Industry Report 72111: Hotels & Motels in the US, www.ibisworld.com.

³ Interview with Airbnb founder and CEO, Brian Chesky, *The Daily Show with Trevor Noah*, Comedy Central, February 24, 2016.

⁴ R. Ali, "Airbnb's Revenues Will Cross Half Billion Mark in 2015, Analysts Estimate," March 25, 2015, skift.com/2015/03/25/airbnbs-revenues-will-cross-half-billion-mark-in-2015-analysts-estimate/.

⁵ Interview with Airbnb founder and CEO, Brian Chesky, *The Daily Show with Trevor Noah*, Comedy Central, February 24, 2016.

⁶ Julie Verhage, "Goldman Sachs: More and More People Who Use Airbnb Don't Want to Go Back to Hotels," February 26, 2016, www.bloomberg.com/news/articles/2016-02-16/goldman-sachs-more-and-more-people-who-use-airbnb-don-t-want-to-go-back-to-hotels.

⁷ D. Fahmy, "Millennials Spending Power Has Hilton Weighing a 'Hostel-Like' Brand," March 8, 2016, www.bloomberg.com/businessweek.

⁸ Y. Nakamura and M. Takahashi, "Airbnb Faces Major Threat in Japan, Its Fastest-Growing

Market," February 18, 2016, www.bloomberg.com/news/articles/2016-02-18/fastest-growing-airbnb-market-under-threat-as-japan-cracks-down.

⁹ R. Greenfield, "Study Finds Racial Discrimination by Airbnb Hosts," December 10, 2015, www.bloomberg.com/news/articles/2015-12-10/study-finds-racial-discrimination-by-airbnb-hosts.

¹⁰ Interview with Airbnb founder and CEO, Brian Chesky, *The Daily Show with Trevor Noah*, Comedy Central, February 24, 2016.