

CASE 2

Airbnb In 2018



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Airbnb was founded in 2008 when Brian 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. By 2018, Airbnb had seen immense growth and success in its 10-year existence. The room-sharing company had expanded to over 190 countries with more than 4 million listed properties, and had an estimated valuation of \$31 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 city officials, owners and operators of hotels, motels, and bed and breakfasts were all crying foul. 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.

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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 as the vacation destination, may contribute to significant operating costs. In total, wages, property, and utilities, as well as purchases such as food, accounted for 59 percent of the industry's total costs—see [Exhibit 1](#).

EXHIBIT 1 Hotel, Motel, and Bed & Breakfast Industry Costs as Percentage of Revenue, 2017

| Costs | Hotels/Motels | Bed & Breakfasts |
|--------------------|---------------|------------------|
| Wages | 24% | 19% |
| Purchases | 27% | 21% |
| Depreciation | 10% | 9% |
| Marketing | 2% | 2% |
| Rent and Utilities | 8% | 11% |
| Other | 13% | 22% |

Source: www.ibisworld.com.

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 2017 is presented in [Exhibit 2](#).

EXHIBIT 2 Major Market Segments for Hotels/Motels & Bed & Breakfast/Hotels Sectors, 2017

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

*The bed & breakfast market was primarily domestic.

**Includes both domestic and international travelers.

Approximately 20% was associated with international travelers.

Source: www.ibisworld.com.

While differing in size and target consumer, all hotels, motels, and bed and breakfasts were subject to city, state, and federal regulations.

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.⁴ A recent Goldman Sachs study showed that once someone used Airbnb, their preference for a traditional accommodation was greatly reduced.⁵ The appeal of the company's value proposition with customers had allowed it 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 2018 estimated market capitalization of \$31 billion to the world's largest hoteliers is presented in [Exhibit 4](#).

EXHIBIT 4 Market Capitalization Comparison, 2018 (in billions)

| Competitor | Market Capitalization |
|-------------------------------|-----------------------|
| Marriott International Inc. | \$49 |
| Airbnb | \$31 |
| Hilton Worldwide Holdings | \$25 |
| Intercontinental Hotels Group | \$11 |

Source: Yahoo Finance (accessed April 2018); "Airbnb Announces It Won't Go Public in 2018," *Business Insider*, <http://www.businessinsider.com/airbnb-announces-it-won-t-go-public-in-2018>.

Recognizing this shift in consumer preference, traditional brick-and-mortar operators were responding. Hilton was considering offering a hostel-like option to travelers.⁶ Other entrepreneurs were constructing urban properties to specifically leverage Airbnb's platform and offer rooms only to Airbnb users, such as in Japan⁷ where rent and hotel costs 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 Yelp, peer-to-peer ratings helped police quality. Both guests and hosts rated each other in Airbnb. This 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.

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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*.¹² Proceeding forward and possibly preparing for a future public offering, Chesky would need to manage how the progressive business model—while fit for the new, global sharing economy—may not fit older, local regulations.