

Airbnb: What's Next?

Prioritizing opportunities in Southern Europe

Introduction

It was a sunny Sunday morning in late November 2014 when Jeroen Merchiers, general manager of Airbnb for Northern, Eastern and Southern Europe, was jogging along the beach in the Barcelona neighborhood of La Barceloneta and reflecting about the future of his business.

Shortly before, Merchiers had been promoted from country manager of Airbnb for Spain and Portugal. He reflected on the region's tremendous growth, how Barcelona had established itself quickly as one of Airbnb's top five cities in the world based on the volume of annual travelers who used the company (about 900,000 since 2008), and on the city's bright prospects for the future.

Despite all the success, Merchiers had some concerns. How could Airbnb sustain its recent success? The company had been valued most recently at \$13 billion. Now the company needed to prove its potential and demonstrate its capacity to grow further. Brian Chesky, CEO of Airbnb, was considering several growth options: dedicating more resources to expansion in Asia; targeting the premium hospitality segment and focusing on creating "better travel experiences"; and possibly developing vacation rental properties. As someone whose opinion the CEO valued highly, Merchiers needed to be prepared to discuss these options in terms of what was best for Airbnb in Southern Europe as well as worldwide.

Besides weighing the different strategies that would help Airbnb to sustain its growth, Merchiers also needed to evaluate how to mitigate some key risks that had surfaced. Uber, a ride-sharing service platform founded in 2009, had been plagued by negative press coverage recently. As an example, Uber's drivers, who by the company's design operated as individuals, had begun grouping together in some cities to petition for higher wages. Given that Airbnb and Uber were both poster children for the "sharing economy," Merchiers felt that

This case was prepared by Professor Mario Capizzani, and Tommy Kim and Stefan Obersriebnig, MBA 2015, as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. December 2015.

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Last edited: 1/11/16



it was important to think of how best to avoid or mitigate similar “unionization” problems and how best to ensure that both hosts and guests would remain happy endorsers of the platform. What would be the right measures to achieve that goal?

Lastly, much like in other countries, Airbnb Spain had been accused recently of failing to comply with the state’s regulatory framework, given that hosts were not officially regulated lodging providers (and hence were not paying any hospitality tax). He needed to prepare for how Airbnb Spain should position itself regarding these legal discussions and determine possible outcomes. Could he afford to ignore the pressure generated by the press or does he need to take action – and, if so, what action should he take first? The company had reached agreements to collect city taxes in Portland, Oregon, and in its hometown of San Francisco, California. Several other European cities, such as Paris, were considering similar agreements.

Company Background

Airbnb had become an alternative solution for short-term home renters and providers worldwide. Since its inception in 2008, Airbnb had become the leading marketplace offering a variety of accommodation around the world (see Exhibits 1 and 2 for Airbnb’s early user growth rates.) By the end of 2014 it had more than 25 million guests and more than 900,000 listings in 34,000 cities and 190 countries – almost every nation in the world except for the likes of North Korea, Iran, Syria, Cuba and the Vatican City State.

Airbnb was a pioneer in incorporating the burgeoning trend of “collaborative consumption” into its “peer-to-peer accommodation rental business model.” This innovative business model, powered by Web 2.0 technologies, was disrupting the traditional hospitality business sector and economy, and it showed strong worldwide adoption and potential growth opportunity. Exhibit 3 gives insight into the economic impact of Airbnb on major cities in the world (Barcelona, Paris, Berlin, Amsterdam, New York and San Francisco). Furthermore, as an example, Exhibits 4 and 5 provide demographic data on Airbnb’s hosts and travelers for Barcelona.

Company History

Airbnb was founded by Brian Chesky, Joe Gebbia and Nathan Blecharczyk in August 2008 in San Francisco. It was one of the first peer-to-peer platforms for accommodation. Unable to afford rent in the fall of 2007, Chesky and Gebbia offered to rent part of their lofts as accommodation for strangers to subsidize their rent. Once they saw the potential business opportunity, they got Gebbia’s former housemate Blecharczyk on board to develop the website to be used as a platform for peer-to-peer property rental.

In early 2009 they received \$20,000 in funding from an angel investor, Paul Graham, the cofounder of Y Combinator, followed by a further \$600,000 in seed investment from venture capitalists. In November 2010 the three cofounders raised \$7.2 million in Series A and, in July 2011, the company received a further \$112 million in venture funding and was reportedly valued behind the scenes at \$1.3 billion.¹ As of October 2014, after two more

¹ <http://www.telegraph.co.uk/technology/news/9525267/Airbnb-The-story-behind-the-1.3bn-room-letting-website.html>.

rounds of financing, the valuation was set to be \$13 billion, up from its private \$10 billion valuation in March of the same year (see Exhibit 6), as it discussed an employee stock sale, according to a report by the *Wall Street Journal*.² As Chesky posted on Twitter in January 2014: “Marriott wants to add 30,000 rooms this year. We will add that in the next 2 weeks.”

Toward the end of 2014, Airbnb forecast 2015 revenues of \$850 million (i.e., more than three times the 2013 reported revenues of \$250 million) and operating losses of \$150 million. The company forecast revenues of \$10 billion by 2020. By comparison, Marriott, which managed more than 4,000 hotels, had \$13.8 billion in revenue in 2014³ and a gross income of \$1.84 billion.

Business Model

Airbnb is a community marketplace where guests can book accommodation from a list of verified hosts. The company had traditionally identified itself as a technology platform that facilitated hospitality arrangements between hosts and guests. As such, it had been exempt from collecting tourist taxes, city taxes or personal income tax from hosts. Signing up to the website is free of charge and it costs nothing to post a listing. This has reduced the barrier for hosts to enter the market. Upon finding the listing that they want, would-be guests need to sign up to the website, which then provides information for contacting the host directly as well as for providing payment information for an accommodation request.

When the host accepts the request and the transaction is in place, Airbnb charges the guest a transaction fee of 6% to 12% and the host a fee of 3%. As the company is unlisted there is no precise information on its revenue, but there have been a lot of forecasts and assumptions in the industry. The investment bank Piper Jaffray estimated the overall transaction volume of Airbnb to be approximately \$4 billion for the year 2014.⁴

By offering free membership and free access to accommodation lists, Airbnb quickly gained traction. Users were free to browse as they pleased and were prompted to pay a service charge only when making a reservation, which let Airbnb maximize the number of potential transactions.

Despite the free listings, sharing one's own home continued to be a daunting decision for many would-be hosts, as a home was typically a person's most cherished asset. Therefore, instilling trust in the platform was paramount for Airbnb in order to get people to share their homes and to ensure guests had pleasant travel experiences. To that end, Airbnb focused its efforts on customer service and satisfaction. Airbnb used the revenue from transaction fees to implement systems such as improved customer verification, \$1 million theft/damage insurance, authentic guest reviews and social media connections. All these efforts contributed to positive word of mouth, which played a key role in generating up to 80% of the guest traffic.

All of these factors, designed with the specific purpose of building trust on both sides of the platform, helped Airbnb create a scalable business model that has led to promising financial returns. Exhibit 7 provides an overview of the average spending of an Airbnb traveler, compared with that of a hotel-staying traveler, for Barcelona and other leading global destinations.

² <http://www.reuters.com/article/2014/10/24/us-airbnb-financing-idUSKCN0ID03420141024>.

³ <http://fortune.com/2015/06/17/airbnb-valuation-revenue/>.

⁴ <http://skift.com/2015/03/25/airbnbs-revenues-will-cross-half-billion-mark-in-2015-analysts-estimate/>.