

AIRBNB DISRUPTIVE BUSINESS MODEL INNOVATION: ASSESSING THE IMPACT ON HOTEL INDUSTRY

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***Abstract:** This paper is an attempt to highlight how business model innovation can be a disruptive force in any industry which can shake the roots of a well-established firm by using a case study on Airbnb. Researchers have studied the business model of Airbnb and underlined how a technology a start-up has come from nowhere and became a 24 billion dollar company surpassing the industry giant like Marriott international Inc. This business model innovation has already resulted in a negative impact of \$2 billion on logging industry and New York City economy accentuating upon the disruptive nature of Airbnb's business model. The study has further highlighted how business model innovation can be source of both internal as well as external value creation and as a source of sustainable competitive advantage which rivals will find almost impossible to imitate.*

***Keywords:** Airbnb, Business Model, Business Model Innovation, Value proposition.*

INTRODUCTION

Globalization and rapid technological developments have given rise to significant level of competition. Companies of almost all sizes and across any industry face huge pressures both to innovate and to decrease their costs. According to Michal Porter only those companies will survive over the long run which will build a sustainable competitive advantage (Porter, 1996). Businessmen and researchers on the other hand believe that product innovation in these turbulent times doesn't provide a sufficient competitive advantage (McGrath, 2011). The rationale behind this is that competitors find it very easy to imitate, technological advances have shortened the product life cycles and in this globalized world rivals from low wage countries mainly from China and India have considerable cost advantages which will put question marks on the profitability from the offering. Therefore companies consider business model innovation not only as an alternative to product and process innovation but also as a source of sustainable competitive advantage (Teece, 2010; Amit & Zott, 2012; Bashir, Yousaf, Verma, 2015).

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According to the IBM CEO study 70 percent CEO's regard business model innovation as a strategic priority and a whopping 98 percent are actively considering changing their business models (IBM, 2008). A similar type of a joint study by Business week and the Boston Consulting Group highlighted that companies which indulge in business model innovations have higher and more sustained returns than the companies which indulge in product and process innovations (Lindgardt *et al.*, 2009). Economist Intelligence Unit (2012) using a survey of more than 4000 senior executives also highlighted that top managers prefer business model innovation as a source of competitive advantage.

This paper will examine the concept of business model innovation and also discuss its various components. The study would demonstrate the implications of business model innovation by using a case study on Airbnb. The study would demonstrate how business model innovation can be source of internal as well as external source of value creation. This paper will further demonstrate how Airbnb has broken all the traditional barriers in hotel industry and has in fact disrupted the way business is being done without any technological advancement and become a common household name touching a record valuation of over \$24 billion in such a short span of time.

LITERATURE REVIEW

The term business model has gained utmost importance and become extremely popular within management, strategy and information systems (Hedman & Kalling, 2003). Much of the surge in the academic literature on business model has been from the advent of dot-com business. Despite surge on academic literature the concept of business model is still underdeveloped and at a budding stage. Researchers and managers still have no common ground in explaining the term business model and its underlying components but all are of the opinion that the concept is very practical, useful in real world and worth of academic study.

Bulk of the literature on business models defines business model as "the ways of creating value for customers, and the way in which a business turns market opportunities into profits through set of actors, activities and collaboration" (Rajala & Westerlund, 2007). According to Morris *et al.* (2006) business model is the unique value proposition of a company, how it capitalizes on its competitive advantage to outperform its rivals and how the firm makes money in present and also in near future. Osterwalder & Pigneur (2010) have also included the value dimension and define business model as a rationale of how an organization creates, delivers and captures value. A business model describes the logic, the data and other evidence that upkeep a value proposition for the customer, a viable structure of revenues and costs for enterprise delivering that value (Teece, 2010).

On the other hand scholars have defined business model innovation as the discovery of fundamentally different mode of value proposition, value creation and value capture in an existing business (Teece, 2010). Researchers also agree that business model innovation can also occur even if only one of the elements or components is changed in the whole business model (Abdelkafi, Makhotin, & Posselt, 2013; Demil & Lecocq, 2010; Lindgardt, Reeves, Stalk, & Deimler, 2009). There is a unanimous opinion by all the researchers that business model innovation is a different form of innovation which is altogether different from product and process innovation (Baden-Fuller & Haefliger, 2013; Björkdahl & Holmén, 2013; Massa & Tucci, 2014). The recent success of companies like Uber, Xiaomi and Dell back in 2000's have all highlighted the perks of an innovative business model. Researchers therefore suggest that the perks of an innovative business model go beyond any other forms of innovation (Lindgardt *et al.*, 2009; Schallmo & Brecht, 2010; Snihur & Zott, 2013).

COMPONENTS OF A BUSINESS MODEL

Majority of the scholars have also defined business models in terms of their components or sometimes some researchers use the term elements. The literature review on the components of business models highlights that researchers have given different components in different papers suiting their research purposes with very little linkage. This has resulted in confusion as to which components to take and which ones to omit. Further almost all of the papers are based on case studies, conceptual or based on theoretical findings with very little empirical support.

One of the most common components discussed by researchers is the value proposition Chesbrough & Rosenbloom, 2002; Dubosson-Torbay, Osterwalder & Pigneur, 2002; Kim & Mauborgne, 2000; Magretta, 2002; Morris, Schindehutte & Allen, 2005; Vorst, Dongen, Nouguier *et al.*, 2002). Researchers have suggested that it's one of the most crucial components in the business model of any firm. Researchers have defined value proposition as the bundle of benefits which a company offers and are of some value to the customer (Osterwalder & Pigneur, 2010).

The other component which has found a mention in majority of the research paper is the assets and capabilities of a firm (Amit & Zott, 2001; Dubosson-Torbay, Osterwalder & Pigneur, 2002; Hamel, 2000; Hedmang & Kalling, 2003; Kim & Mauborgne, 2000; Morris, Schindehutte & Allen, 2005). Researchers have defined assets and capabilities as the people who are working for the organization, technology which an organization possesses, equipment's, machinery, information channels, partnerships and even the brand (Johnson, Christensen & Kagermann, 2008). Capabilities and assets are a must in implementing and even developing a business model (Morris, Schindehutte & Allen, 2005).

The next subsequent component discussed by researchers is the revenue and pricing model or some researchers call it economic logic or revenue logic (Chesbrough & Rosenbloom, 2002; Dubosson-Torbay, Osterwalder & Pigneur, 2002; Hamel, 2000; Kim & Mauborgne, 2000; Timmers, 2000; Westerlund, 2008). The revenue model usually includes monetary features of providing services and features. It includes the various procedures which are used for payment, what is being paid for, how much is being paid (Osterwalder & Pigneur, 2010). Revenue model embraces the veins of revenue, pricing strategies and pricing (Bouwman, Vos & Haaker, 2008).

The other component which has also found a mention in almost all of the papers is the value network (Chesbrough & Rosenbloom, 2002; Dubosson-Torbay, Osterwalder & Pigneur, 2002; Hamel 2000; Hedman & Kaling, 2003; Hoque, 2002; Kim & Mauborgne, 2000; Timmers, 1998; Vorst, Dongen, Nouguier & Hilhorst, 2002). Value network usually includes suppliers, coalitions which are required in delivering and creating value for customers in a value network (Hamel, 2000).

Many other elements like key relationships, key activities, and customer relationship have also found a mention (Osterwalder & Pigneur, 2010). Researchers particularly Hamel (2000) have also discussed customer interface, fulfilment and support. Amit & Zott (2001) have discussed information flows. The reason for such diversity in the components of the business model is the lack of empirical research as bulk of the studies are either theoretical, conceptual or based on case studies.

BUSINESS MODEL INNOVATION BY AIRBNB

The basic principle which any hotel chain follows before setting up the infrastructure is going around and studying the competition in the vicinity. They work out on differentiation prospects and try to create a distinctive set of features which will differentiate their offering from its competitors. Then usually hoteliers would work on marketing strategies in order to find ways of drawing customers from competitors, work on the promotion aspects, the after sales services and many other countless things. Airbnb defines itself as “a social website that connects people who have space to spare with those who are looking for a place to stay”, rather than a chain of hotels. The company acts as an intermediary operating on a marketplace platform model wherein it connects hosts and travellers enabling transactions without owning any of the rooms in itself (Choudary, 2013).

The business model of the company on the one hand is very disruptive but on the other hand it's very simple. Property owners list their apartments or in some case spare rooms on the Airbnb website. The property owners establish their own nightly, weekly or monthly prices and offer accommodation. The company on the other hand charges the guest as well as the host. Guests usually end up paying a 9-

12 percent reservation fee for every booking they make also depending on the extent of the stay and on the other hand hosts pay a 3 percent service fee to accommodate the cost of processing the payments. The company has come up a long way since its launch in the year 2008. The company has 1,500,000 listings in 34,000 cities round the globe covering 190 countries (Company website). This is the reason why the company is valued at more than \$24 billion which is more than the hotel industry giant Marriott International Inc. having a valuation of \$21 billion despite having more than 4000 hotels and a revenue of around \$13.8 billion in 2014. (Winkler & Macmillan, 2015).

As of now the business model of Airbnb operates with very minimal or almost no regulatory control in majority of its locations worldwide. Therefore one of the biggest challenges of this model is to build trust and maximise the possibility of a successful booking. To solve this problem company has built an online rating platform which enables and in fact encourages guests and hosts to review and rate each other. Guests usually rate on the parameters like cleanliness, location and communication. Guests and hosts are both encouraged to posts their ratings on the platform provided.

The study has used Westerlund (2008) framework for explaining the components of the business model. Westerlund has divided business model into following components:

1. Value Proposition.
2. Assets & Capabilities
3. Economic logic or Revenue logic
4. Actors in Business Network.

The prime rationale for using this model is that it has been developed after reviewing all of the literature on business model and only those components have been picked which are most valid and on which all of the researchers have consciousness. Secondly the model with some minor adjustments is also in line with Osterwalder & Pigneur 2010 and Amit & Zott, 2001 which further justify its usage.

The impact of this business model innovation on each of the parameters can be explained under the following headings:

VALUE PROPOSITION

This business model innovation has maximised both the internal as well as the external value proposition. If we look at the internal vale Airbnb not only enabled users to list their apartments or spare rooms but also provides insurance to the listed properties. The company is giving very cheap options along with an option of customization for travellers for a homestay and not a hotel. In order to bring in

transparency and earn customers trust the company has a review and rating system wherein host and guests can rate each other. The guest can rate the facilities based on aspects like Cleanness, Ambience, Location and Communication.

ASSETS & CAPABILITIES

One of the biggest assets which the company has is its global presence in more than 190 countries having more than 1,500,000 listings in 34000 cities (Company website). The Company also has a very robust, up to date and effective Information system in place which connects hosts with the guests at ease. The other thing which the company has is the presence of a local host which puts the company at a competitive edge. The company unlike others hoteliers doesn't spent big dollars in building tall infrastructure like building hotels and properties which again puts it at a competitive advantage with respect to its competitors.

ECONOMIC LOGIC OR REVENUE LOGIC

The beauty of the model lies in its pricing and revenue streams. The company doesn't set the prices of the rooms or the apartments listed on its website. The company gives that liberty to the owners and they charge on nightly basis, weekly basis and also monthly basis. The company makes money by charging both sides i.e. the guest as well as the host. Guests usually end up paying a 9-12 percent reservation fee for every booking they make also depending on the extent of the stay and on the other hand hosts pay a 3 percent service fee to accommodate the cost of processing the payments. As far as the cost is concerned the company has almost no cost as all of the costs whether its repair, maintenance, quality checks and even the workforce costs like receptionist are to be paid by the host who has listed the property on the website.

The company doesn't disclose its earnings but as per some internal memos and reports from consulting firms the company is expected to grow up to revenue of \$10 billion by 2020. The forecasts highlights that the company would be profitable and will touch \$3billion of EBITDA (Earnings Before Income Tax Depreciation and Amortization) by 2020. The company currently has a market share of around 1 percent at a global level, therefore in order to meet the revenue forecast the company has to reach up to a market share of around 10 percent. (winkler & Macmillan, 2015).

ACTORS IN BUSINESS NETWORK

The Company has cut down almost all of the intermediaries and wholly and solely relies on its website and the application for smartphone users. Airbnb also has a close association with landlords who rent their spare rooms or apartments and freelance photographers who take photograph of the properties in order to get

them listed on the website. In addition to this some venture capitalistic firms like Greylock Partners & Sequoia Capital have invested heavily in Airbnb.

IMPACT ON HOTEL INDUSTRY

A recent report conducted by HVS consulting and valuation in association with Hotel association of New York estimated that Airbnb had a negative impact of \$2billion on logging industry and New York City economy. The report highlighted that the disruption is very real as over 2,800 jobs were lost due to the emergence of Airbnb as the company has removed demand from the market. Among these 2842.30 people lost their jobs directly, 508.1 people lost their jobs indirectly and around 693.1 people lost jobs due to the induced effect. Therefore \$200 million was lost in direct labor income. The study further concluded that \$226 million dollars are annually lost in tax revenues for local, state and federal governments (See figure 1). The impact was highlighted for twelve months starting from September 2014 to September 2015. The revenue of the company is expected to grow exponentially in the coming years which means the impact will further widen. This brings into perspective the disruption which this business model can have is not only on the hotel industry but on the general economy as well.

Hotel industry is in a boom and has witnessed six consecutive year of heavy growth where demand has outstripped supply. Airbnb which is an online rental company has come up from nowhere and emerged as an alternative to hotels and as a major competitor. The beauty of this business model is that the company is

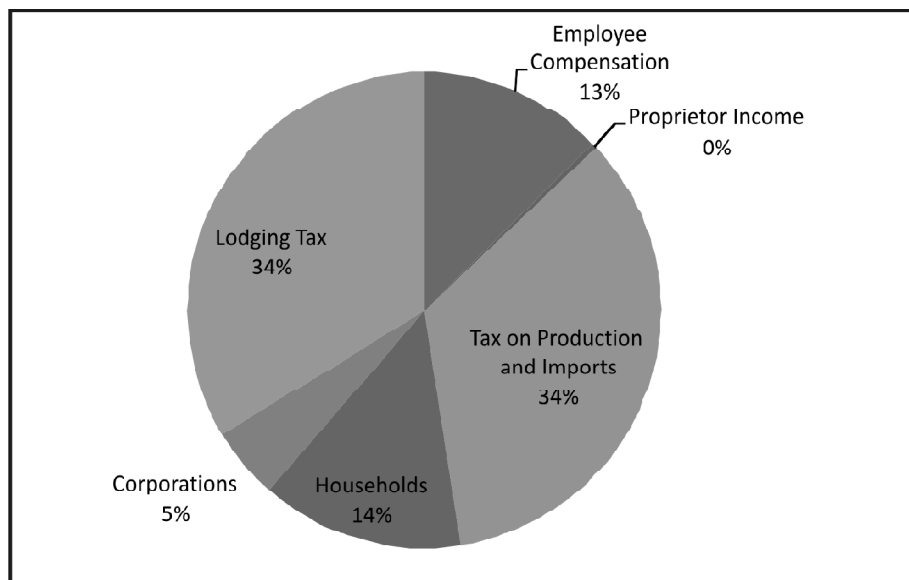


Figure 1: Distribution of Taxes Lost in New York City (Source HVS, 2015)

able to increase the supply in no time and lower the rental rates. In spite of a heavy last six years of growth hotel REITs have produced a return of -22.2 percent as of September 30, 2015 compared to a performance of -4.3 percent for MSCI US REIT index (Bloomberg: RMS). A measurable impact on the income statements is yet to be calculated but the recent decline in the hotel REIT and C-Corp prices can also be credited to the rise of Airbnb (See figure2).

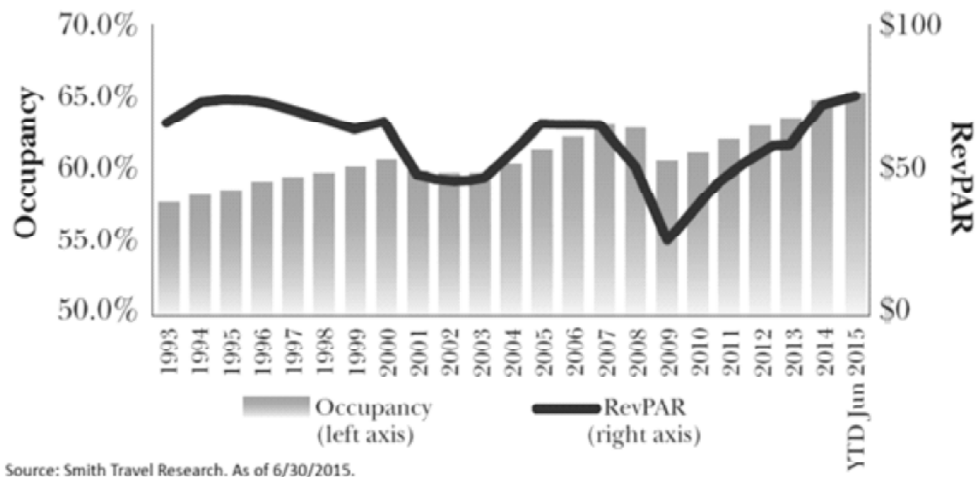


Figure 2: Trends In RevPar

CONCLUSION

The study highlights the disruptive nature of technology start up Airbnb. The company is driven by a desire to solve a problem and has a very unique way of creating and delivering value. In contrary large corporations always look at beating their competitors by product or process innovation. The study points out that business model innovation can reshape and reconfiguring the value mechanism in any industry and can have huge economic implications which would not only be industry specific but to a much wider level and in fact to the general economy. The study brings a very important dimension in picture that any industry particularly service industry which requires huge investment upfront to create supply would always be in a state of treat and can be disrupted by any platform offering novel ways of value capture and new sources of supply by offering lower level services.

The study also highlights that business model innovation can be a huge source of both internal as well as external value creation. The company has broken all the traditional barriers and supply mechanism in the hotel industry by bringing new sources of supply which industry rivals never considered as they are mostly confined to beating out competition by differentiating their services rather than focussing on business model innovation. The study further highlights that business

model innovation can be source of sustainable competitive advantage which rivals would find very difficult to imitate.

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