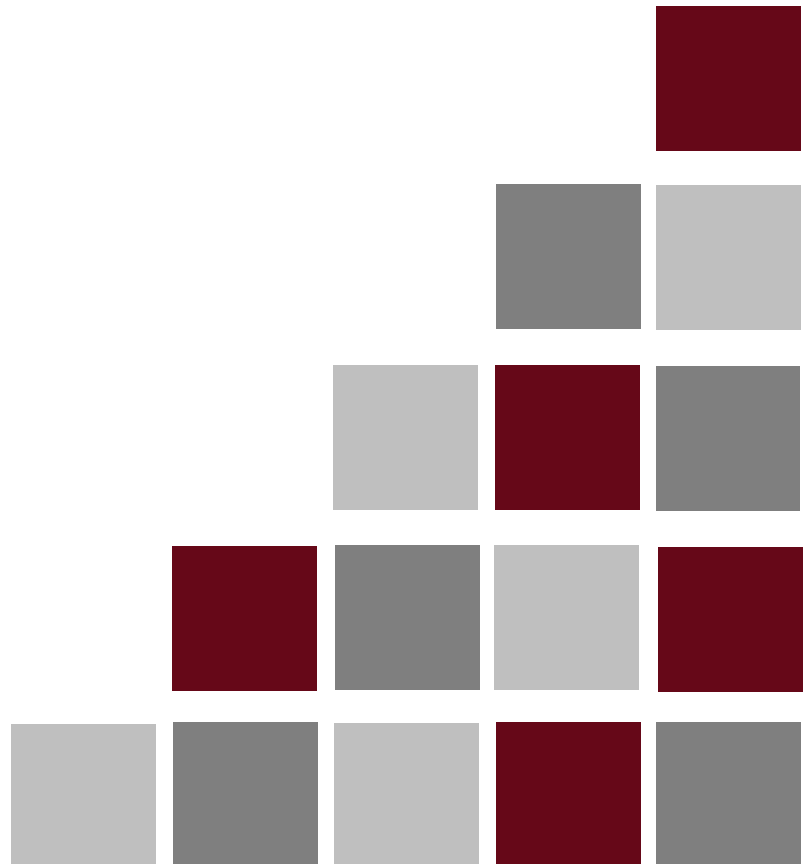


# Principles by IUCG:

## *Analyzing Disruptors in the Hotel Industry*

*Alejandro Acosta, Le Jie Bennett, Nicholas DeCastro*



# INDUSTRY OVERVIEW

## *What is the Hotel Industry?*

Hotels, motels, and resorts are benefiting from global increases in tourist travel, but short-term rental services, such as Airbnb, are disrupting the industry in global markets. Online travel agencies like Expedia have also influenced the competitive dynamic of the US industry by siphoning off revenue in the form of commissions that hotels must pay on each booking. Both of these trends largely impact large hotel chains, which are fighting for stricter regulation of private rentals, while negotiating more favorable contracts with third-party booking websites.<sup>1</sup>

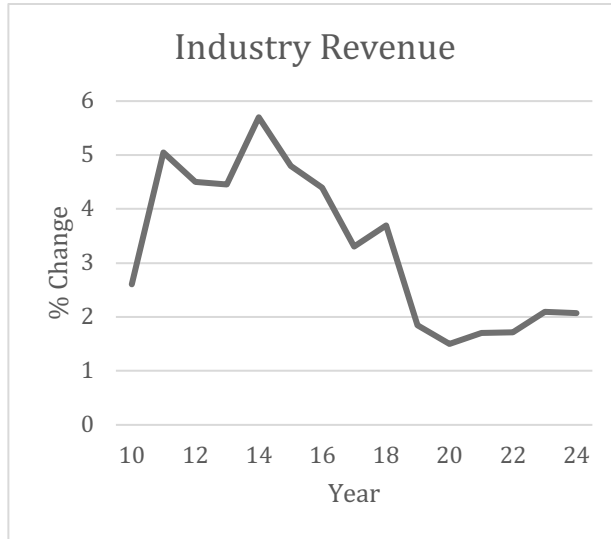
## *Industry Overview*

From limited to full service models, hotels encompass a large range of sizes and services. Full service models tend to be larger in size and are most often located in metropolitan areas. Services range widely from food and beverage service, conferences rooms, convention accommodation, and more. The key characteristic that differentiates hotels from motels is layout and accessibility. Motels typically provide direct access to parking from each room, while hotels have a higher degree of separation from room to parking. Major players in the hotel industry include Marriott International (the largest hotel company), Hilton, and InterContinental Hotels Group (a U.K. based company appealing to a younger, more affluent demographic). The hotel industry has grown at an annualized rate of 4.4% over the past five years and is forecasted to grow 1.7% annually in the following five years.<sup>1,2</sup>

# PRODUCTION

## *Volatile Economic Dependency*

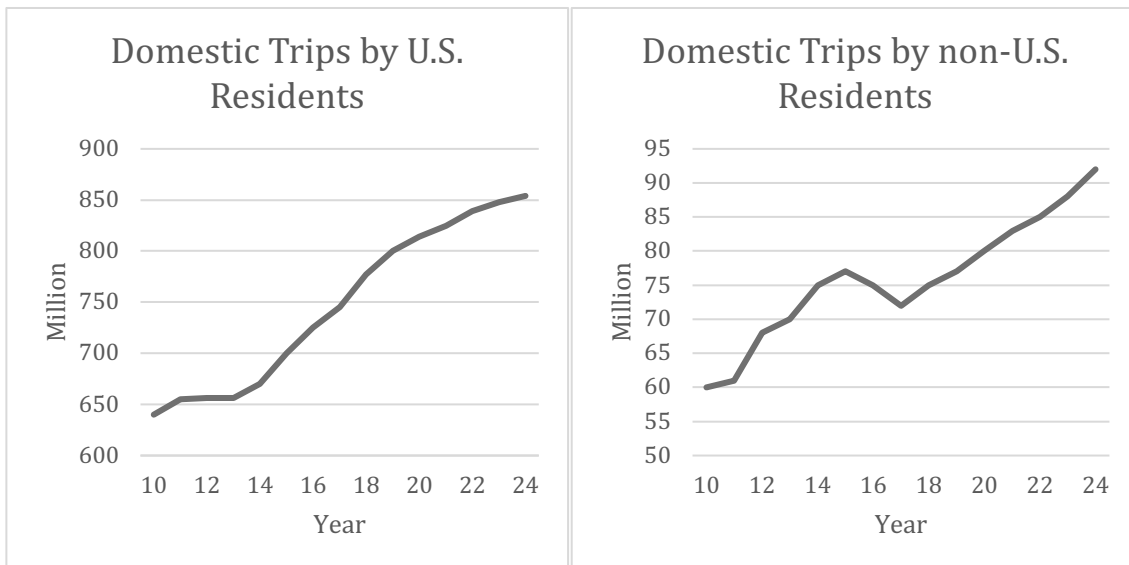
Hotels are susceptible to market fluctuations and offer a service that is price elastic. Especially in moments of recession, hotel profits and employment decline faster than the national average. This is due to traditional hotels' high fixed costs that require a relatively high level of demand to just break even.<sup>2</sup>



Source [www.ibisworld.com](http://www.ibisworld.com)

4

One crucial economic driver of the hotel industry is the consumer confidence index, which measures consumer confidence about the current economic outlook. When consumers feel more optimistic about the future, they are more likely to plan vacations and trips. Vacation and trip planning declines when consumer confidence is more pessimistic. Trends in both international and domestic travel also have a large impact on the hotel industry. The expected increase in domestic travel trips in the short run highlights a potential opportunity for the hotel industry to capitalize on. The 5.7% increase in industry revenue occurred during the same year international travel experienced its own respective increase of 7.2%. Expected increases in domestic travel could also positively impact revenue lines in the hotel industry. Demand for hotel and motel accommodation is also dependent on other factors that affect travel such as shifts in disposable income, interest, and tax rates. These changes affect the number of trips a household takes as well as the amount spent during travel.<sup>2</sup>



Source [www.ibisworld.com](http://www.ibisworld.com)

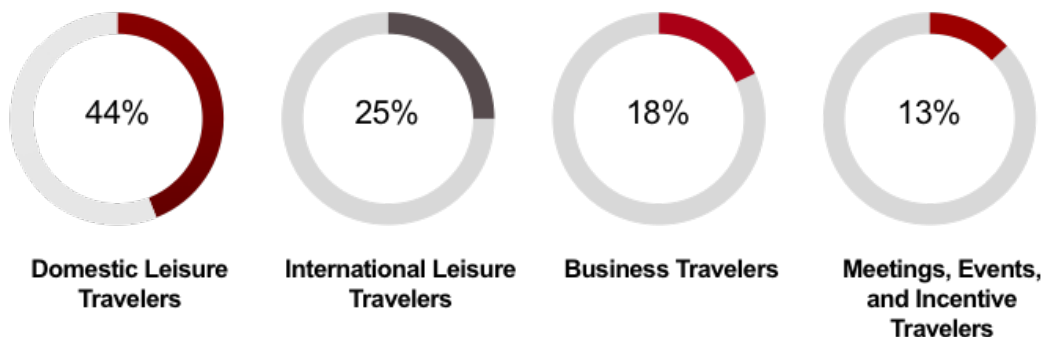
4

### ***Supply and Demand Industries***

Demand for rooms has been consistently increasing. This demand for hotel rooms, coupled with a gross undersupply, has led to a shortage of available rooms. This undersupply allows hotel operators to charge more for rooms even with lower occupancy rates. Due to the rising costs of rooms, known within the industry as RevPAR (revenue per available room), Online Travel Agencies and services such as Airbnb have been able to take advantage and reap the benefits of the growing demand pool. Airlines are complementary to hotels, and often will have long standing relations with a specific hotel chain, offering incentives to travel customers to stay at these facilities. Hotels, for this reason, most often construct properties near airports as well as within metropolitan areas.<sup>2</sup> On the supply side, a vast majority of hotel's supply industries consist of various food wholesalers as well as furniture and technology wholesalers.<sup>2</sup>

### ***Revenue Streams***

Most revenue is derived from the renting of rooms. However additional revenue streams include full service bars and restaurants which usually supplies the hotel about 12.9% of the annual revenue. Conference demonstrate a growing source of revenue, accounting for about 6.6% of revenue in 2018. Catering meals, laundry, and valet services account for roughly 3.1% of annual revenue.<sup>2</sup>



Business trends that require immediate hotel response, in addition to OTAs, include a new consumer awareness on sustainability and environmental practices, which have an extremely high initial cost, despite long term benefits. In addition, new challenges from alternative lodging industries such as Airbnb and HomeAway have hotels placing pressure on governments to regulate these companies, who are heavily impacting the lower tier hotels.<sup>6</sup>

# RISING TRENDS: ECOMMERCE & OTAs

## *Overview*

The globalization of travel and the rise of ecommerce travel platforms has had both positive and negative impacts on the hotel industry. On one hand, the internet has increased the quantity of information and data available to companies, while also assisting in the reservation process, enhancing targeted marketing campaigns and increasing overall industry efficiency. At the same time, the rise of the internet has also given way one of the hotel industry's largest obstacles: Online Travel Agencies (OTAs)

## *Online Travel Agencies*

Online Travel Agencies provide consumers a wide selection of hotel brands, prices, and locations, all stacked up against each other in one easily navigated network space. The two major players in the American OTA market are Priceline and Expedia, who collectively control 95% of the market.<sup>5</sup> Typically, hotels pay between 12-25% in commissions to these agencies for online bookings through their platforms. Despite this high cost, OTAs play a key role in booking and reservation volume. On average, OTAs provide 21.6% of bookings for a given hotel, while 33% of reservations are booked directly from hotel websites.<sup>1</sup> Since retaining customers loyalty and ensuring repeat sales is integral to the hotel industry, the emergence and dominance of OTAs pose a major challenge to hotels.

## *Industry Reaction to Online Travel Agencies*

In an effort to reduce costs associated with OTAs, hotels have created contracts with these agencies that include rate parity agreements. These agreements prevent OTAs from charging substantially lower prices from their customers in comparison to standard direct booking prices. Hotel operators are offering discounted rates and other perks to encourage guests to book reservations directly with the hotel rather than through a third-party website. Hotels also gain more control over the relationship with the customer when they book directly, which can help boost enrollment in loyalty programs while reducing marketing costs.

**Examples:** In 2016, Hilton Worldwide launched the "Stop Clicking Around" multimedia ad campaign. Hilton's campaign drove home the fact that it offers best price guarantees and other benefits to guests who book directly through Hilton's own web sites, rather than online travel agencies. As a result, many hotels began offering best price guarantees to incentivize direct booking.<sup>1</sup>

# KEY DISRUPTOR: AIRBNB INC.

## *What is Airbnb Inc.?*

Airbnb Inc., a San Francisco based company, emerged in 2008. Airbnb operates as a sharing economy and brings a new, disruptive approach to the traditional hotel industry.

## *Key Elements of Airbnb*

1. **Sharing Economy:** Airbnb provides an online marketplace where hosts and guests come together to rent or lease a variety of lodging options including apartments, homestays, hotel rooms and vacation stays. These lodgings can range from basic economy styles to luxury accommodations. In addition to lodging, Airbnb hosts can also provide experiences for their guests. These experiences provide guest an opportunity to immerse themselves in a more personal, local experience through activities such as food and wine tastings, crafting workshops, or outdoor hikes.
2. **Online Platform:** Airbnb's success can be attributed to its mobile app and website platforms where hosts post listings and property details regarding accommodations, amenities, availability, cancellation policy and photographs. This allows guests to easily search through the listings either by a specific filter like location and availability, or through Airbnb's top recommendations.
3. **Community:** Airbnb's online platform creates an all-inclusive Airbnb community where both the voices of guests and host can be heard. Guests can review their experience after every booking, which gives insight to prospective guests. Reviews provide assurances regarding experience quality and integrity, which builds consumer trust in Airbnb as a platform and its hosts. Guest are also able to connect directly to hosts through the platform, allowing the transaction and experience to run efficiently. Airbnb also provides a supportive community for hosts through hospitality tips, blogs, professional photography, 24/7 support and an online forum that helps them run and market a successful location.<sup>7</sup>

## ***Economics Behind Airbnb***

The reservation price for properties is determined from the following categories:

<b>Determinants of Reservation Price<sup>8</sup></b>	
	Rate per night
	Cleaning fee
	Extra guest fee (6-12%)
	Airbnb service fee (0-20%)
	Currency exchange fee
	Value added tax
+	Local taxes
<hr/>	
	<b>Total cost of reservation</b>

Of the above-mentioned price determinants, hosts determine the rate per night, cleaning fee, and extra guest fee. Airbnb generates revenue from two different sources: hosts and guests. From hosts, Airbnb collects a 3% commission for every rental booking and a 20% commission for every experience booking. From guests, the company collects revenue in the form of the Airbnb service fee, which uses a variety of factors including reservation subtotal, length of stay, and characteristics of the listing to determine the percentage.

## **COMPARISON: HOTELS & AIRBNB**

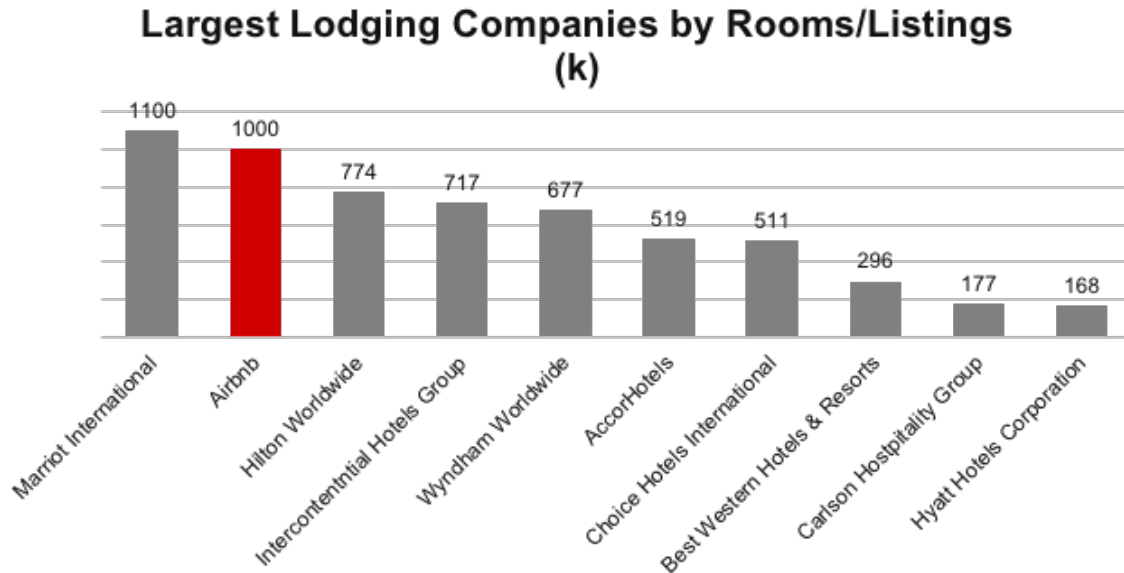
### ***Nature of Business***

**Airbnb:** Operating in a sharing economy, Airbnb has a supply elasticity twice that of its hotel counterparts. After analyzing market conditions, hosts can decide whether they want to opt-in or out of the market.<sup>9</sup> Airbnb offers a wide variety of lodging and experiences, however there is limited standardization between products, making it difficult to enforce regulation. Only about 35% of Airbnb listings are directly comparable to hotel rooms.<sup>10</sup>

**Hotels:** Hotels, with their traditional business models, have a more fixed supply and little supply elasticity. Depending on demand, hotels either have an excess or a shortage of supply. During low demand, hotels lose money on empty rooms. During periods of high demand, hotels are able to charge higher prices. Hotels are typically controlled by corporations that can enforce standardization and consistency within their products. However, these corporations have high fixed costs associated with maintenance and human capital. High capital investment is required to expand, and revenue is lost due to the usage of online travel agencies.

### **Available Lodging**

With approximately 35% of Airbnb's listings being directly comparable to the average hotel room, Airbnb is the second leading lodging company with available hotel rooms.<sup>10</sup>



### **Challenges**

**Airbnb:** As a sharing economy-based business, Airbnb faces legal hurdles regarding safety, tax regulations and insurance issues. From a consumer perspective, the company must be able to develop trust between the hosts and the guests and develop a method of standardization or regulation of listings.

**Hotels:** Hotels lack the same level of supply elasticity as Airbnb and must find ways to quickly adapt to market conditions. They also must continue to find accommodations that can compete with unique and personal listings while maintaining low costs and competitive pricing.

### **Customer Base**

**Airbnb:** Guests are typically younger with 60% of the reservations made by millennials. Bookings through Airbnb tend to be leisure-based as individuals look to book longer stays.<sup>11</sup> Typically, this market chooses Airbnb because of (1) price (2) location (3) authentic experience.

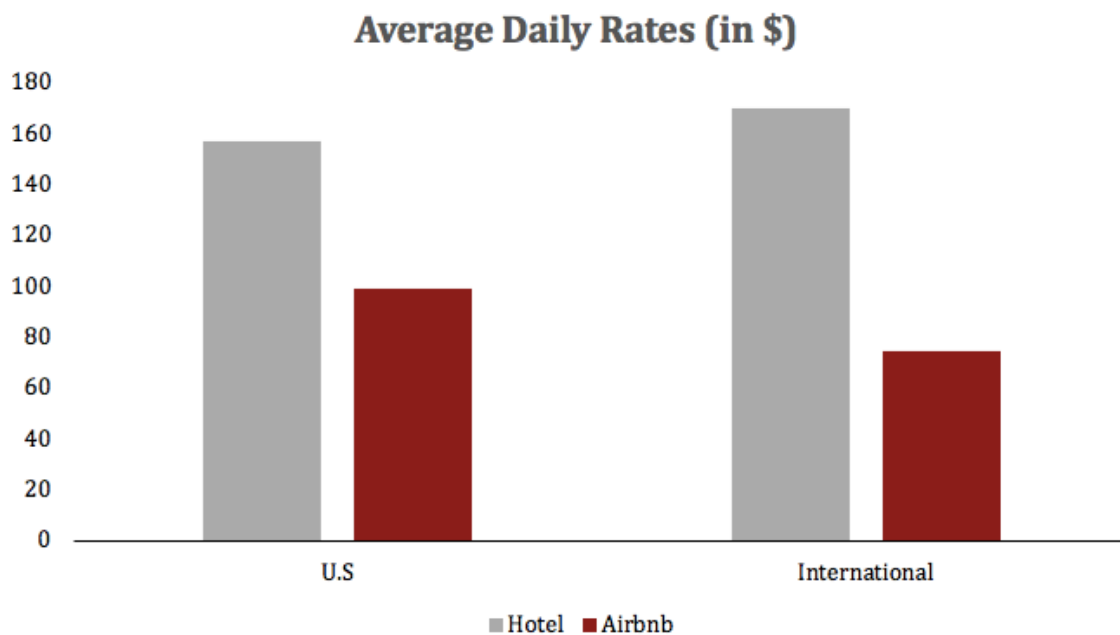
**Hotels:** Guests are typically older and are motivated by business-based travel. This demographic tends to book shorter stays. Individuals select hotels because of name recognition and standardization of rooms. They do not select Airbnb because (1) lack of recognition and awareness (2) privacy and safety concerns and (3) uncertain logistics.<sup>12</sup>



# INDUSTRY IMPACT

## *Supplement*

In situations when there is a high consumer demand for lodging and a fixed number of hotel rooms, Airbnb acts as a supplement to hotels. Worldwide, in some of the largest cities, hotels and Airbnb competitively coexist. Where hotel occupancy is high, so too is Airbnb occupancy. These occupancy percentages move together depending on the level of consumer demand. When consumer demand for lodging is high and there is a fixed number of rooms hotels can offer in a city, prices for hotel rooms are high due to the simple effects of supply and demand. This is how Airbnb can use its flexible supply to accommodate market trends and take advantage of increase demand. Hosts can opt to expand the room capacity of a city, thus providing guests a new cheaper supplement to high hotel room prices.<sup>10</sup>



13

## *Substitution*

According to a survey conducted by Morgan Stanley in 2015, 42% of guests stated that they used Airbnb as an accommodation to replace hotels. For this survey, this was the most common response among survey participants. Respondents selected Airbnb specifically for its price, location and authentic experience respectively.<sup>12</sup> When prices are no longer competitive, consumers tend to use Airbnb as a substitute for hotels, rather than as a supplement. Coupled with the other amenities that Airbnb offers, in the long run hotels could face increased competition with Airbnb.

### ***Reduction in Hotel Revenue***

Airbnb has increased competition with traditional hotel companies by attracting guests with their low prices. This increase in competition has forced traditional hotels to lower their prices, which has affected profit margins. In the top ten cities with the largest Airbnb presence, hotels have lost on average 3.7% in profit. In addition, for every increase in review score of an Airbnb property, hotels loss \$25.54 on hotel revenue per available room over 101 samples. The hotel the industry as a whole as lost 1.54% of revenue since the emergence and growing utilization of Airbnb.<sup>9</sup>

### ***Consumer Surplus***

Consumer surplus increased by \$276 million as consumers received \$41/Room night in consumer surplus at Airbnb compared to \$26/room night at hotels.<sup>9</sup>

## **ADDRESSING AIRBNB: LARGE SCALE**

### ***Overview***

Airbnb has rapidly expanded in the lodging industry, taking away market share from prominent brands such as Hilton and Hyatt. The company has rapidly built upon their success by offering a more affordable alternative to hotels and a more personal experience. Hotels have begun to combat Airbnb through two separate campaigns: lobbying politicians and merging with other hotel brands.

### ***Lobbying Campaigns***

The American Hotel and Lodging Association (AHLA) is developing a “multipronged national campaign approach at the local, state, and federal level.” There have been attempts to increase government awareness of Airbnb’s operating activities and to establish new laws and regulations against the company. Airbnb is now under investigation by the Federal Trade Commission. Initiatives to control Airbnb’s low-cost structure and address the absence of the Corporate Hotel Tax of 6% have begun in New York, Chicago, and San Francisco. While the hotel industry is heavily regulated by laws such as Safety and Consumer Protection, these high cost limitations do not yet apply to Airbnb.<sup>14</sup>

### ***Merging Campaign***

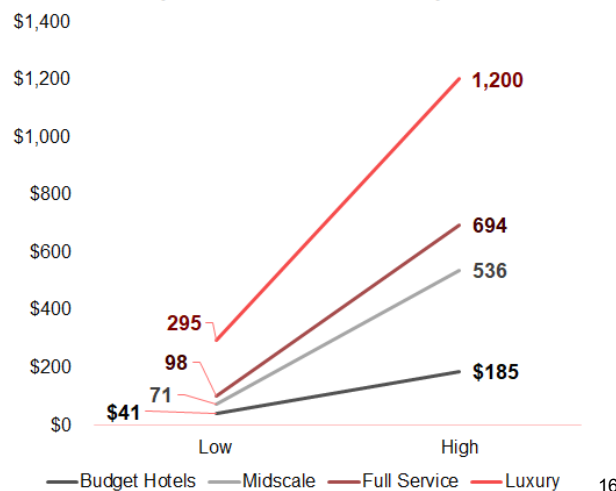
Recently, Marriott International Inc. and Starwood Hotels and Resorts Worldwide Inc. merged, a decision that has improved the company structure and allowed the company to better compete with Airbnb. This merger will create better loyalty programs, which will work to improve customer retention as well as increase the company’s margins through economies of scale. This is a new solution to the industry, and one that many believe will be effective in addressing Airbnb’s lowered cost. The Marriott-Starwood merger could serve as a successful model to lower costs and better compete with new players in lodging.<sup>15</sup>

# ADDRESSING AIRBNB: SMALL SCALE

## *Revamping the Interface*

Besides the other two aforementioned solutions proposed by the hotel industry, hotels are also exploring revamped interfaces to address new challenges and competition. Hotel accommodations are becoming more “home-like”. Hyatt House and Hyatt Place are two new hotel models that offer laundry and in-room kitchens to allow guests to experience familiar luxuries of being at home when they are travelling. This is one of the main determinants influencing consumers to stay with Airbnb. They appreciate the abilities to have a kitchen and other amenities in a room, all while being able to feel the comfort and ease of being at a “home away from home”. However, there is a significant cost associated with upgrading and changing hotels to this new model. These hotel amenities are considered between Full-Service and Luxury. The range of costs to create these hotels is between ~98K and ~1.2M.<sup>16</sup>

### TOTAL EXPENSE RANGE TO OPEN HOTELS (IN THOUSANDS)



## *Personalization*

The hotel industry can expect the best results regarding adapting to the changing industry by increasing the personalization associated with their brands. Through giving a holistic analysis of the hotel industry, and the impact Airbnb has had on key players, innovations such as enhanced User Profiles could augment the customer stay and booking experience. Hotel may soon offer reservations for local dining options or activities in the area that directly align with their consumers’ preferences. Another opportunity is to partner with a media partner, similarly as to how Uber has worked with Spotify. For example, hotels could explore partnerships with Netflix, which could allow guests to stream personalized content rather than offering regular cable and Pay-Per-View movies. Capitalizing on increased and augmented personalization could lead to success for hotels in the future.<sup>17</sup>

## REFERENCES

1. "Lodging - Industry Overview." *Hoover's Company Records*, Hoover's, subscriber.hoovers.com/H/industry360/overview.html?industryId=2002. Accessed 9 Dec. 2018.
2. Hyland, Rachel, editor. "Hotels and Motels in the U.S." *Ibis World*, IBISWorld, Oct. 2018, clients1.ibisworld.com/reports/us/industry/default.aspx?entid=1661. Accessed 9 Dec. 2018.
3. "Market Research and Trends." *Plunkett Research Online*, Plunkett Research, 17 Aug. 2018, www.plunkettresearchonline.com/ResearchCenter/Trends/display.aspx?Industry=17. Accessed 9 Dec. 2018.
4. Airbnb Company Overview." *Off-Campus Login*, Marketline Advantage, 29 Oct. 2018, advantage.marketline.com.silk.library.umass.edu/Product?ptype=Companies&pid=75E7EF7F-48E9-4D11-9331-8BEE945B8BD1.
5. *Cincinnati 2018 (with Photos): Top 20 Places to Stay in Cincinnati - Vacation Rentals, Vacation Homes - Airbnb Cincinnati*, www.airbnb.com/help/article/1857/what-is-the-airbnb-service-fee.
6. Farronato, Chiara, and Andrey Fradkin. "The Welfare Effects of Peer Entry in the Accommodation Market: The Case of Airbnb." *National Bureau of Economic Research*, 2018, www.nber.org/papers/w24361.
7. Haywood, Jessica, et al. *Airbnb & Hotel Performance*. STR Inc, 2017, *Airbnb & Hotel Performance*.
8. "Airbnb Statistics for Demographics and Growth." *IPropertyManagement.com*, ipropertymanagement.com/airbnb-statistics/.
9. Nowak, Brian, et al. *Internet, Lodging, Leisure and Hotels*. Morgan Stanley, 2015, *Internet, Lodging, Leisure and Hotels*.
10. "Business Travel Management | Airbnb For Work." *AirbnbForWork*, www.airbnbforwork.com/.
11. Benner, Katie. "Inside the Hotel Industry's Plan to Combat Airbnb." *The New York Times*, The New York Times, 16 Apr. 2017, www.nytimes.com/2017/04/16/technology/inside-the-hotel-industrys-plan-to-combat-airbnb.html.
12. Whitmore, Geoff. "Details Surrounding the Marriott and Starwood Merger." *Forbes*, Forbes Magazine, 18 Apr. 2018, www.forbes.com/sites/geoffwhitmore/2018/04/18/details-surrounding-the-marriott-starwood-merger/.
13. "U.S. Hotel Development Cost Survey 2015/16." *HVS*, www.hvs.com/article/7730-us-hotel-development-cost-survey-201516.
14. Shashou, Alex. "Four Ways Hotels Can Better Compete against Airbnb." *Insights*, 20 June 2018, insights.ehotelier.com/insights/2016/02/25/four-ways-hotels-can-better-compete-against-airbnb/.