



Xiaozhu.com:

A case study on the sharing economy

Xiaozhu.com is a typical sharing economy start-up, using a platform business model to match Chinese consumers seeking short-term rental accommodation to those with property to let. It is similar to the US start-ups Airbnb and HomeAway, which are currently the dominant players in this space in many countries. Xiaozhu.com closed a US\$60 million Series C round of funding in July 2015. Two of its founders and its main investor shared the company's

start-up story with CEIBS China Entrepreneurial Leadership Camp participants on November 6, 2016. The following is a translated, edited and condensed version of this talk by Chen Chi, Wang Liantao and Li Xiao. Read on to learn first-hand how they solved some of the challenges faced in building the two sides of the platform, how Xiaozhu.com differs from its US-based competitors, and some of the unique aspects of running an enterprise that leverages the sharing economy.



Chen Chi: *The New Digital Age*

Chen Chi, a former obstetrician and gynaecologist, worked at Qihoo, Kuxun.cn and Ganji.com before co-founding Xiaozhu.com with Wang Liantao in May 2012.

“Every platform business should have a ten-year development plan. The first major issue that needs to be solved is how to develop both sides of the platform – in order to promote transactions there needs to be both users and suppliers. It took Xiaozhu two to three years to sufficiently develop both sides of its platform in order to then be able to begin building the brand and business ecosystem, and improving user experience.

Our transaction platform was set up to address the issues of supply, customers, market infrastructure, as well as the transaction environment – it would pave the way for transactions by allowing buyers and sellers to resolve the problems of moral hazard and adverse selection. With Xiaozhu.com we were stepping into a brand new market in China. No one had set up this kind of business before, which meant we had to start from the ground up in creating both supply and demand. There was no infrastructure, and even worse, there were many inconveniences in the transaction environment for accommodation sharing.

Initially none of the lodgings on Xiaozhu.com were independently operated. During our first two years of operations we had to solve the problem of creating a supply of properties available for rent, which turned out to be very costly. Why did we send photographers to the hosts to take good photos? Because we needed to ensure there was reliable information for the renters. We also took an active role in helping the hosts to furnish their places and gave them suggestions to make their properties attractive to customers. In the beginning, hosts were responsible for the headlines and descriptions of their properties, and I would verify the accuracy by visiting every single lodging in person. If I found anything that was improper or unclear, I would ask my colleagues to work with the hosts to make changes.

In order to make sure the platform would quickly have enough available properties to list, we began to rent lodgings in cities such as Beijing and Shanghai. With our knowledge of consumers’ demands, we selected a variety of places, including studio apartments and units with one, two or three bedrooms. This enabled us to control the inventory as well as the furnishings. At first we charged RMB120-140 per night, but as we found demand was rather broad, we added properties that

we could rent for RMB500-800 per night, and even villas that rented for RMB2,000-3,000 per night.

Most of our efforts in those early years were spent getting from zero to one – we needed to solve the problems of creating a supply of properties and increasing the variety of accommodations, as well as improving the transaction environment. We didn't pay much attention to building traffic and a user base.

Taking it to the Next Level

We are in touch with local government officials, and at all levels they have been very supportive of the sharing economy, which is in line with China's economic transformation away from heavy industry; supply-side reform policies want to leverage existing assets and spare labour in order to improve productivity.

The short-term rental market has grown quickly in the past year, especially in first-tier cities. We have begun to get traction on both sides of our platform. Now, at this stage, our challenges have to do with the user experience; many of the issues come from consumers and hosts. There is an increasing number of hosts willing to share their residences because the threshold for sharing is low enough; this is all part of the user experience. But for some hosts, the logistics make it difficult to participate on the platform. For example, they would say, 'I'd like to share my place,

but you need me to receive the guests every day, and my wife needs to do all the cleaning. All of this makes it impossible.'

Building up the number of users is, of course, important. The rise of the mobile internet and new media has been helpful in that regard. Many established traditional online players such as Ctrip and Qunar are finding it challenging to attract millennials who are not familiar with such PC-era platforms. It's a great opportunity for companies to build new brands in a new media and communication environment. The digital entrepreneurship environment in China has already evolved to a new era that will serve these young users.

In the future, Xiaozhu will focus on improving user experience and brand development. Of course, China's consumer credit rating system will undergo big changes in the coming years. We have a rigid real-name registration system, and China's system for this is one of the strictest

in the world. We also need to develop a financial credit verification system. In my opinion, it's not enough to create a third-party credit score, which Xiaozhu is now demanding from new users. If we can set up a convenient and reliable credit rating system, and settle all the issues with a real-name registration system, fraud issues can be resolved – not only for Xiaozhu, but for everyone.

I have learned a lot as the company developed. We are full of confidence in China's future, because my outlook on society's future is seen through the prism of this micro-environment of the sharing economy. We will be a society full of strangers, who can establish trust through new, real-name registration credit systems which will resolve the problems of adverse selection and moral hazard. Greedy self-interest will decrease, and altruism will increase. This is a conclusion we have drawn from our experience with our house-sharing enterprise in the sharing economy."





Wang Liantao: Challenges Spur Innovation

Wang Liantao & Chen Chi have been friends for 10 years and are now start-up partners.

“Xiaozhu.com has introduced a number of innovations to the short-term rental business model. For example, the accuracy of the information exchanged between hosts and guests is very important. So we took photographs of the properties and established a verification procedure. Another example: furnishings are one way that lodgings signal their quality and improve their competitiveness, so we decided to provide furnishing services, and give hosts suggestions on renovations and décor. Also, knowing that people need to know who they are doing business with, we introduced real-time authentication. Given the size of Chinese cities, it’s difficult for hosts and guests to meet to pass along house keys, which prompted us to launch the first smart key system in the industry to solve this problem [once a lease expires, the landlord simply uses his mobile phone to change the password that unlocks the door]. But our most successful innovation this year has been our cleaning service. We used crowdsourcing to find part-time cleaners to service rental units through our platform.

Our platform has grown from a relatively weak start-up into a business with various modules. To me this kind of growth comes from unceasing exploration and evolution. The volume of transactions done on Xiaozhu reached almost RMB1 billion this year. Can we introduce finance and insurance mechanisms? This is the new question that has arisen from the current stage of our business. Users’ problems signal opportunities, and as we encounter problems they push us forward to make changes to the platform.”





Li Xiao: Making the Tough Calls

Founding Partner of Joy Capital and lead investor in Xiaozhu.com.

“Xiaozhu.com is very unique among the investments I have made in my career. I have been the lead investor through several rounds of the company’s fund raising, and we have experienced many challenges as the company has developed. It was especially difficult in the first few years due to some issues in China’s business environment.

In the past year, there have been frequent references to the ‘bottoming out’ of entrepreneurship. I think this will be the norm for a while. All the low-hanging fruit has been picked; the days of an asset-light business model easily raking in the money have come to an end.

Let me explain, from the supply chain perspective, why so many e-commerce platforms have failed. Actually the key things for e-commerce platforms are traffic and supply chain. Every time there is a new thing that can drive traffic we will all claim it’s an opportunity for vertical e-commerce. In 2011 and 2012, many vertical e-commerce platforms sprang up, but almost none have lasted. When mobile internet developed, everyone said mobile traffic would pay dividends. Many vertical e-commerce platforms did emerge from the mobile internet, but today, in retrospect, there are still few that can rival Taobao. As a result, supply chain challenges are increasingly daunting.

Control the Pace of Development

You need to know the essence of the business you are in. What is the environment like? How fast should you develop? To be honest, if we had adopted a model that heavily subsidised users, we would probably not be sitting here with you sharing our experiences.

The short-term rental market became an instant hit in 2012. The first company we saw in this space was HomeAway, which has adopted a really asset light model. The US vacation rental market is very standardised. HomeAway puts the information about vacation rentals online, and collects an annual fee from property owners. It has developed into a company with a market value of more than US\$2 billion. Many others began to attempt this simple asset-light model of connecting renters with owners.

Some would say that every city has a variety of available sublets in different neighbourhoods, so if I just put the lodgings they have on my platform and run the business with an asset-light model, isn’t that enough? However this will not work, because these hosts have no sense of service. They are short of good infrastructure,

and lack payment links. In addition, in the early stages, the mobile internet market was not that big, and because communication was being done online using a computer it sometimes took a host two to three hours to reply to a potential client. The user could have a really bad experience. If we had chosen to develop rapidly at that stage, we would have died. Instead we were inspired to develop a tempo for the company's development.

Why have I continued to invest in this company? Because as it's grown, I have seen that things I was concerned about have been changing. In the early stages, I knew that China's housing stock was considerable. I saw there was a high demand for transitional housing, and the market was huge, which implied a great demand for this kind of business. At the beginning, we didn't know what kind of business model could work in China, and just sensed vaguely that it would be a long-term opportunity. I found that this company shared my thinking, and I looked at this investment as a long-distance race.

From my point of view, a start-up aimed at building a platform must be doing something that differentiates it from everyone else. Take e-commerce as an example. Everyone says Taobao's vertical departments are not doing well, which creates an opportunity to set up an alternate transaction platform. But if the differentiation of the platform is not that obvious, and you are just attracting a few customers

from Taobao with your slightly better products, it won't be enough for customers to stick with your platform. If you really want to differentiate yourself, you must do something very tough, something that others don't want to do.

Sharing Economy Business Models

The sharing economy is an area where we see great promise. It is not a very new topic, so why is it getting so much attention? There are many reasons for this. Its users are more likely consumers than businesses, the supply side has undergone many changes, and some consumers have become suppliers. It is also because of the emergence of transaction platforms, such as Xiaozhu.com.

“Building up the number of users is, of course, important.”

I also think there has been a shift in Chinese society: where in the past China lacked everything, now there is an excess of many things, including resources. There is also a change in the way that people live and consume. For example no one would have predicted

that we would have a “co-working” workplace style – a shared work environment where employees from different organisations work together. Many people say that WeWork's success in the US is because there are many freelancers there, so this model would not apply in China. However, we have invested in similar companies, and many of them are getting good traction. Of course, the power of technology and mobile devices has also played a role in making the once-seemingly-impossible sharing economy possible.

However, the sharing economy has more than one business model. For example, when it found Kuaiche could no longer provide standard services, Shenzhou Zhuanche chose to make group purchases available in its back-end system, providing uniform quality services via management. Doesn't this also count as part of the sharing economy? I think this is a way to optimise the use of resources by putting them together, and it is a type of sharing economy.

In Xiaozhu's first stages of development, due to lack of supply and an unwillingness to put low-quality listings on the platform, it had to adopt an asset-heavy model. We have more than 400 lodgings on the platform that we developed. At a meeting last week, we agreed that they had fulfilled their purpose and were no longer needed. This shows that if there isn't ‘heaviness’ at the beginning, you can never realise ‘lightness’ later.”