

# Search Frictions and the Design of Online Marketplaces

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[http://andreyfradkin.com/assets/Fradkin\\_JMP.pdf](http://andreyfradkin.com/assets/Fradkin_JMP.pdf)

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## Abstract

Search and matching markets are increasingly intermediated by online marketplaces. These marketplaces record novel data about search activity and influence search through policies, such as ranking algorithms, which can make matching outcomes more efficient. I use data from Airbnb, a prominent online marketplace for housing rentals, to show that potential guests engage in limited search, are frequently rejected by hosts, and inefficiently match as a result. I estimate a micro-founded model of search and matching and use it to show that if frictions were removed, there would be 84% more matches in the marketplace and host revenue would increase by \$109 per searcher. I propose several improved ranking algorithms for the marketplace and show that they would increase the matching rate by up to 10% over the status quo. However, the A/B search experiments favored by internet companies can be biased by over 100% for the true treatment effect because of equilibrium effects.

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# 1 Introduction

Online marketplaces have transformed how consumers search for jobs, apartments, spouses, and consumer products. I study the efficiency of these marketplaces and whether outcomes can be improved by better marketplace policy. My empirical strategy uses detailed data on searches and transactions from Airbnb, a prominent online housing marketplace. I propose three mechanisms that cause inefficiencies in these markets: that consumers cannot consider all options available, that consumers don't know which sellers are willing to transact (due to seller screening, "stale vacancies," or congestion), and that some transactions may occur inefficiently early. I build an empirical model that allows me to measure the impact of these frictions and use it to study platform changes aimed at improving matching efficiency.

I find that frictions still play an important role on the internet and that marketplace policy can reduce the negative consequences of those frictions. Searchers on Airbnb typically view only a subset of potential matches in the market and more than 40% of listings remain vacant for some dates. Furthermore, sellers reject proposals to transact by searchers 49% of the time, causing searchers to leave the market although there are potentially good matches remaining.<sup>1</sup> Frictions in the market lead to less transaction volume, consumer surplus and revenue. If searchers had information about all the options in the market and knew which sellers were willing to transact with them, there would be 84% more matches and revenue per searcher would be \$109 higher.

I propose and evaluate several new ranking algorithms aimed at improving market efficiency. The preferred algorithm increases the match rate by 10% in counterfactual simulations. However, because there is test-control interference, the treatment effects of an A/B test are generally not consistent for the true effect of a policy change. Lastly, I find that ranking algorithms affect the relative contribution of searchers and sellers to the total number of matches in the market. This is especially important because, although the search technology has changed in matching markets, most models of matching do not allow for the shape of the aggregate matching function to change over time. Although I focus on ranking algorithm design in this paper, my modeling framework can be used for other difficult problems such as optimal marketing strategies, price recommendations and platform fees.<sup>2</sup>

The setting of this paper is Airbnb ("Airbed and Breakfast"), a rapidly growing online marketplace for housing rentals that has served over 9 million guests between 2008 and late

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<sup>1</sup>Horton [14] documents a similar negative effect of rejections on subsequent search effort in the context of Odesk, an online labor market platform.

<sup>2</sup>For example, one difficult issue for Airbnb has been to ascertain the marginal value of a host versus guest in a given market. This answer is impossible to answer well in a framework without cross-user externalities and other network effects.

2013. Airbnb provides a platform for individuals to temporarily rent out an unused room or property to travelers.<sup>3</sup> Search on Airbnb begins when potential guests submit their trip details, which consist of a city, dates of stay, and number of guests, into a search engine. The search engine returns a set of listings in that city. If a listed option is appealing, the searcher sends an inquiry to the host of that listing.<sup>4</sup> An inquiry typically asks about the availability of the listing and sometimes asks about other listing details. The host’s response is indicative of a complex decision to let a stranger stay at her place. This decision combines issues of trust, availability, hassle, and the possibility of better offers. If the host accepts, then the searcher can choose to book the place.

Airbnb is an excellent environment for studying search and matching frictions for several reasons. First, as in the labor and dating markets, both sides of the market have heterogeneous preferences towards the other side. Second, because hosts can only accommodate one trip for a set of dates, there is a potential for large congestion frictions. Burdett et al. [4] show that markets where sellers have limited capacity (such as Airbnb, the dating market, and the housing market) are characterized by different matching functions than settings where sellers have a large capacity such as the college admissions market. Lastly, the Airbnb dataset contains search, communication, and match behavior, whereas many datasets used for studying search and matching markets lack search and communication data. An especially important piece of information that I observe is whether the buyer or seller rejected the transaction. Analogous data in the labor market would contain resume submissions, interview invitations, and interview outcomes at a searcher-vacancy level.

I estimate models of consideration set formation, directed search, and rejection and combine them into a simulation of market outcomes. The consideration set model determines how many pages are seen by each searcher, which filters are applied on each page and what listings are ultimately seen. This model is estimated using unique data from actual browsing and filtering behavior of searchers on Airbnb. The directed search model determines which listings from the consideration set are contacted by searchers. It is estimated using data on inquiries sent from guests to hosts. In that model, the searcher’s utility for a particular listing is a function of listing characteristics such as location, size, and price and the match quality between guest and host. For example, searchers for trips with more guests prefer bigger properties and searchers who use a price filter are more price sensitive.

Upon receiving an inquiry, hosts choose whether to reject or accept a potential guest.

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<sup>3</sup>Similar marketplaces to Airbnb exist in industries such as contract labor (Odesk, Freelancer and Taskrabit), dating (OkCupid, Match.com and eHarmony), craft goods (Etsy and Ebay) and personal transportation (Uber and Lyft).

<sup>4</sup>Airbnb has been expanding its “Instant Book” feature, which allows searchers to book a listing without communication.

Rejection by hosts happens in 49% of all inquiries. There are three distinct causes of rejection in search and matching markets: screening, congestion, and “stale” vacancies. Screening occurs when a host rejects a searcher because of the searcher’s personal or trip characteristics. For example, some hosts may not be comfortable sharing a space with an individual who has no reviews. To capture the host’s decision process, I estimate a logistic regression of hosts’ screening decisions as a function of guest and host characteristics. Congestion occurs when a searcher sends an inquiry to a listing that is about to transact with another searcher. Rejections due to congestion arise endogenously in my model because transactions take time to clear. Lastly, rejections due to stale vacancies occur when a listing which is not actually available for a given week is nonetheless visible in search and contacted.<sup>5</sup> In my dataset, over 20% of communications are screened, over 21% are sent to stale vacancies and less than 6% are affected by congestion.<sup>6</sup> This result is interesting because much of the theoretical literature on directed search such as Kircher [17], Albrecht et al. [2] and Burdett et al. [4] has focused on congestion as the main cause of rejection in search markets.<sup>7</sup>

I combine the above models into a simulation of how the market clears over time. In the simulation, searchers enter Airbnb looking for a place to stay in a given week and market, and conduct search according to the directed search model. Inquiries sent by the searchers are either accepted or rejected by hosts according to the reasons above. If a guest chooses to book a property, the transaction takes time to clear. Additional searchers enter the market sequentially and send inquiries. The actions of searchers and hosts then generate the aggregate matching and rejection probabilities. The simulation comes within several percentage points of matching the empirical booking rates, contact rates, and rejection frequencies even though these moments were not used to determine the model parameters. This model is similar to the model of online dating in Hitsch et al. [13], which includes directed search and screening. However, unlike in the setup in that paper, my setup allows me to quantify frictions<sup>8</sup> and to study the effect of the marketplace search engine on outcomes.

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<sup>5</sup>Stale vacancies are similar to congestion from the perspective of the searcher but are generated by a different seller behavior. Therefore, policies that reduce rejections due to congestion do not necessarily reduce rejections due to stale vacancies and vice versa.

<sup>6</sup>There is no good data, to my knowledge, on these rejection reasons for other markets. Analogous rejection reasons in the labor market are as follows. Screening rejections occur when a job applicant is not qualified for the job. Congestion rejections occur when a suitable applicant applies to a vacancy that is about to be filled by another applicant. Stale vacancies occur when a vacancy is listed although the employer is not hiring.

<sup>7</sup>However, see Chade et al. [6] for an example where college applicants do not know which college will accept them.

<sup>8</sup>In Hitsch et al. [13], 68.3% of men in the sample never match with a partner. However, the paper does not examine the extent to which those rejections are inefficient.

Because search frictions are large, marketplace policy can potentially improve outcomes. The policy space for online marketplaces encompasses search ranking, site layout, new matching mechanisms and explicit rules that affect the behavior of agents. Most marketplaces rely on experimentation to learn about the effect of a particular policy. However, experimentation is of limited use in search and matching markets for three reasons. First, estimated treatment effects from searcher level experiments can be biased. The market level effect of a policy can differ from the individual effect because whenever a searcher books a room, other searchers cannot book the same room. Therefore, the degree to which a treatment helps an individual depends on how many other individuals have also received the same treatment and how many good matches remain in the market. Second, the parameter space of possible marketplace policies is too large to explore with experimentation alone. For example, a ranking algorithm that uses machine learning might have thousands of parameters. Lastly, the effect of policies depends on time-varying market conditions such as the number of agents in the market and the ratio of searchers to sellers. An experiment, on the other hand, is typically run in a specific time period and set of markets. Understanding how market conditions affect outcomes can inform experimental design and can help the marketplace designer adapt policies to different situations.

I use the model to simulate outcomes on Airbnb with counterfactual search rankings. To my knowledge, this is the first paper to quantitatively model the effect of ranking algorithms in a search and matching market.<sup>9</sup> I propose three ranking algorithms, one that shows more relevant listings on average, one that shows listings tailored to each searcher based on listing quality and one that shows listings which maximize transaction probabilities for each searcher. I show that all policies improve outcomes and that the later two algorithms improve matching probabilities by 10%. I also simulate the results of the A/B tests favored by internet platforms to determine which policies to pursue. I show that the treatment effects estimated from A/B tests are typically different from the market level treatment effects and that they can overstate the true effects of a policy by over 100%.

The approach taken in this paper differs from the aggregate matching function approach used in many papers concerning search markets (Petrongolo and Pissarides [23]). Aggregate matching functions stipulate that the number of potential matches given a set of searchers and vacancies is determined by a matching technology which is not, in general, based on micro-foundations. The lack of micro-foundations makes aggregate functions unsuitable for studying policies, technologies, and changes in market structure which affect the matching

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<sup>9</sup>Ghose and Yang [11] and Santos and Koulayev [26] study the effect of ranking algorithms in generic hotel search engines where seller preferences are unimportant. Horton [14], Casadesus-Masanell and Halaburda [5] and Hagiu and Jullien [12] propose theoretical models where platforms have incentives to alter searchers' behavior through ranking algorithms.

process. For example, Lagos [20] derives a micro-founded aggregate matching function for the taxicab market and shows that its shape will be sensitive to policy. Similarly, policies in my model change the relative contribution of searchers and sellers in the matching function. Specifically, a better ranking algorithm increases the weight on hosts and decreases the weight on searchers in the matching function. This occurs because each searcher gets better search results and is more likely to match holding the quality of hosts constant.

The paper is organized as follows. Section 2 gives more detail about Airbnb. Section 3 describes the model of directed search and section 4 describes the determinants of rejection. Lastly, section 5 describes the model and shows the empirical results.

## 2 Data and Setting

### 2.1 Airbnb Background

Airbnb describes itself as a trusted community marketplace for people to list, discover, and book unique accommodations around the world — online or from a mobile phone.<sup>10</sup> It is a fast-growing startup that was founded in 2008 and that has more than doubled the number of guests accommodated in every year of its operation. In 2012, Airbnb accommodated over 3 million guests and listed over 180 thousand new listings. It has listings in more than 34 thousand cities worldwide and is available in more than 30 languages.

Airbnb has created a market for a previously rare transaction: the rental of an apartment or part of an apartment in a city for a short term stay by a stranger.<sup>11</sup> These transactions were not occurring previously because there were large costs to securely exchanging money, communicating with strangers and evaluating a stranger’s trustworthiness. Airbnb was one of the first platforms to provide a set of tools and services which enabled guests and hosts to arrange stays in a relatively risk-free manner. These tools are important because hosts on Airbnb are typically non-professionals, over 80% of whom list just a single room or property.

In a typical Airbnb transaction, guests and hosts have the ability to inconvenience each other by being disruptive or by lying about the characteristics of a room or trip. Communication occurs on the platform both to screen counter-parties and to confirm the details of the trip such as the key exchange and check-in times. Importantly, hosts are allowed to deny potential guests for any reason. Guests and hosts have the opportunity to review each other after the trip. In subsection 3.2, I show that the stock of reviews on the site provides impor-

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<sup>10</sup><https://www.Airbnb.com/home/press>

<sup>11</sup>Couchsurfing, a large travel based social network started in 2003, facilitates similar stays but without monetary exchange. Craigslist has listed sublets and short-term vacation rentals since the late 1990’s. Vacation rentals by owners in tourist towns have also existed for a long time.

tant information and affects both host and guest behavior.<sup>12</sup> Users of Airbnb can disclose information about themselves through photographs and textual descriptions. Airbnb also provides free professional photography services to hosts and verifies users' identity using online social networks (Facebook, LinkedIn, and Twitter) and passports or driver's licenses.<sup>13</sup> In the empirical section I show that this information is important in the decisions of agents on Airbnb.<sup>14</sup>

The payments mechanism on Airbnb is a big innovation compared to previous platforms for accommodations such as Craigslist, where payments were handled offline. The marketplace holds payments in escrow until the stay has happened in order to prevent fraud. The escrow service allows Airbnb to resolve disputes between guests and hosts and to enforce the payment of security deposits and cancellation penalties. Airbnb also offers a one million dollar insurance guarantee against major damage done to properties by guests. Airbnb generates revenue by taking a percentage fee of every transaction that takes place on the platform. Hosts typically have a 3% fee while guests have a variable fee that ranges between 6% and 12% depending on the details of the transaction.

Another important service that Airbnb provides is the management of pricing and property calendars. For each date, each listing has a binary availability that is displayed on the site. If a booking occurs, a host's calendar is automatically blocked off for the dates of the trip. Alternatively, the host can manually update the calendar to be unavailable for a set of dates. In either case, the property can no longer be booked and will not show up in search for the blocked off dates. Hosts might not update their calendars even if they are unavailable because they are uncertain about future availability, want to see potential guests or face updating costs. As a result, potential guests send inquiries to seemingly available listings which are actually off the market.

## 2.2 The Search and Matching Process

Below is a list of steps each searcher undergoes before a match occurs. Even though the examples below are from Airbnb, each of these steps occurs in other search and matching marketplaces.

1. Using the Search Engine (Figure 1) - Searchers enter the travel dates, number of guests and location into a search engine and receive a list of results. The search can then be refined using filters and maps.

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<sup>13</sup>There is a literature that documents the importance of reviews in a variety of online platforms. For example, Pallais [22] shows that reviews are valuable and under-provided on Odesk, a labor market platform.

<sup>14</sup>For more details see: <http://blog.airbnb.com/introducing-airbnb-verified-id/>

<sup>15</sup>Lewis [21] shows that information voluntarily disclosed by sellers on Ebay Motors affects market prices.



2. Investigation (Figure 2 and Figure 3) - The searcher clicks on a listing in search. The subsequent page displays additional photos, amenities, reviews, responsiveness, house rules and information about the host.

3. Communication (Figure 4) - The guest sends messages to hosts inquiring about room details and availability. A host can respond by saying that the room is unavailable, that the room is available or by asking a follow up question. The host might also not respond at all. A guest may send multiple inquiries both initially and after receiving responses.

4. Booking - If a transaction is agreed upon, the guest can click the “Book It” button. If the host accepts, the money is charged and taken in escrow by the platform. Some transactions occur without a messaging step if the host allows the “Instant Book” feature.

5. Stay - After a trip is booked, there is further communication needed to exchange keys and coordinate the details of the trip. Either side can cancel with a pre-specified penalty rate.

## 2.3 Data Description

My dataset contains the full set of inquiries and transactions that occurred in major US markets on Airbnb. Appropriate subsamples of the data are used throughout the paper. In this section, I narrow my data set to comprise all contacts to US markets which occurred for trips starting in 2012, while in the model sections I focus on one market and a narrower set of dates. For each communication I observe the time a message was sent, who sent the message, who received the message, and the content of the message. Each set of messages between a guest and a host is aggregated into a “thread” that contains information about trip dates, the number of guests, and the room of inquiry.

I group each set of communications in my dataset by search spell (alternatively referred to as a trip attempt). A search spell is defined as a set of inquiries and transactions pertaining to a stay by a specific guest in a specific market and in a specific week of the start of the trip. For each searcher, I observe the number of reviews, the number of pictures, demographics and other characteristics. For each property and date I observe the listed price, number of reviews, review score, location, number of pictures, and other characteristics.

There are some limitations to the dataset. I do not always observe the correct price in cases when a host changes prices for a specific date over time. The reason for this is that the data on date specific pricing is from monthly snapshots rather than from daily snapshots. This is not a major problem because most hosts do not set date specific prices and instead use a calendar wide listed price. Further, I do not observe the entire path of availability in the market. For example, a property might initially be available for a given week, then



become unavailable and then become available again. In that case, I treat that property as always being available. Lastly, some of the observed characteristics such as age and gender are either missing or entered inaccurately by users.

## 2.4 Identifying Host Rejections

In this section I describe how to classify whether a host’s response to a guest indicates that the host is interested in the transaction. For example, the response “Sorry, the place is unavailable.” should be classified as a rejection whereas the response “Yes it is available. Go ahead and book it.” should be classified as a non-rejection.

I use a combination of approaches to determine whether a response is a rejection. If an inquiry led to a booking or was labeled as accepted by the host then it is classified as “not rejected”. If a response was labeled by the host as a rejection or if there was no response within a week then the response is classified as a rejection.

If the response does not fit into any of the above categories, a text classifier is applied to the first (or in some cases second) response by a host to a guest. I use a common technique in natural language processing called a regularized logistic regression to classify text (see [Appendix A](#) for details). I combine the text classification with cases when the response is discernible through other methods.<sup>15</sup>

In total, 49% of all inquiries were rejected. Of all responses classified as rejections, 37% were non-responses, 30% were classified by the host, and 32% were classified the regularized logistic regression. As a consequence, communication on Airbnb frequently fails to result in a transaction. For US Markets in 2012, just 15% of inquiries and 48% of search spells transact.

## 3 Search Behavior

### 3.1 Consideration Set Formation

Empirical models of consideration set formation are important for studying marketplace policy for three reasons. First, many matching technologies (such as algorithmic recommendations) affect outcomes through their effect on consideration set formation. Second, because it is almost impossible to exactly recreate the ranking algorithm used on the site, there needs to be an empirical analogue to the true ranking procedure. Lastly, most product search engines include various filters and tools to help searchers. Therefore, it is necessary

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<sup>15</sup>Foreign language responses are removed from the analysis.

to model the filter usage of searchers. The complexity of browsing behavior is a general problem for analyzing search data from the internet and is not unique to this setting. In this section, I describe a simple model of how searchers use Airbnb’s search engine.

Potential guests on Airbnb search for a place to stay by entering a location, a set of dates and the number of guests into a search engine. For each query, the website returns a maximum of 21 available listings according to a ranking algorithm. Searchers can then continue to the next page of results for a given query or they can modify the search parameters by using filters or a map (seen on the left side of Figure 1). These types of refinements are frequently used on sites such as Airbnb, where the stock of listings is very heterogeneous. Figure 5 displays filtering frequencies per search and searcher. Over 80% of searches and searchers use at least one filter or map action. The most commonly used browsing actions (in order of frequency) were room type filter, map, maximum price filter, neighborhood filter and the next page of results. I do not model filtersthat are used less than 5% of the time such as those pertaining to bedrooms, beds, and bathrooms.

Listings are ordered for each query according to their algorithmically determined scores, with highest scores first. Each score is a function of listing (but not searcher) characteristics and the distance of the listing to the query. In a typical session, searchers do not see all listings because there are hundreds or thousands of available listings in a city.<sup>16</sup>

The dataset for estimating the ranking function is composed of the set of listings that could have been displayed in search for a random sample of generic searches in the market of study. To be in the set, listings must be available for the set of dates of the search and must be able to accommodate the number of guests selected in the search. For each such listing,  $h$ , I observe a set of observables and whether it was displayed in the first search without filters for a given searcher at time  $t$ .

I use this dataset to estimate the following equation:

$$h_{seen,hts} = 1(X'_{ht}\mu + \gamma_s + \epsilon_{hs} > 0) \quad (1)$$

where “seen” indicates whether the listing was displayed in the first search,  $X_{ht}$  are listing characteristics,  $\gamma_s$  is a searcher specific fixed effect and  $\epsilon_{hs}$  is a logit error term. The ranking score of each listing,  $w_{ht}$ , in the simulation of market outcomes is then set to the predicted index,  $X'_{ht}\hat{\mu}$ , resulting from the above regression.

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<sup>16</sup>Searches in October of 2013 for stays in New York, Seattle, San Diego, Austin, Los Angeles, Chicago, Miami and many other cities resulted in more than 1000 search results.

<sup>18</sup>In the summer of 2013, Airbnb launched a new interface with a map that takes up half of the screen. This paper studies the period before that feature was launched. Sorting by price was not possible during this period.

The second aspect of consideration set formation is browsing and filtering behavior. In the model, as in the data, the first page that an individual browses displays the 21 best visible listings in the market according to the ranking scores,  $w_{ht}$ . Afterwards, the searcher then draws individual specific preferences for neighborhoods, prices, and room types. The frequency of each individual specific preference is taken to be the frequency of that filter being used, conditional on at least one filter of that type being used. For example, searchers who use at least one room filter, pick the “entire room” filter 83% of the time. Therefore, each searcher will draw a preference for “entire room” with probability 83%.

Following each page view, the searcher can go to the next page of results, can apply a set of filters to a new search, or can stop searching. Denote these browsing actions,  $A_i$ . I model the probability of each action occurring as a multinomial logit with the index for  $A_i$  equal to:

$$\beta_{0i} + \beta_{1i}N \tag{2}$$

$N$ , is the chronological order of the search action for a given searcher.<sup>17</sup> The index for the action of doing a new search is normalized to 1. For each filter type, the probability that it is applied upon action “New Filter” is determined as a function of  $N$ . Tables 1 and 2 display the coefficients which determine the probability that each action and filter is used as a function of  $N$ . The coefficients on  $N$  are positive in the filtering models, confirming that filters are more likely to be used further along in the search process. In the simulation, the filter that is applied, i.e. room type entire or private, is determined by the randomly drawn individual preferences. The full consideration set is determined by the union of the listings seen in the browsing session determined by the above process.

I abstract away from two important aspects that are present in actual consideration set formation: the effects of ranking within a page<sup>18</sup> and endogenous browsing behavior. I assume that the ranking of a listing within a page does not affect the consideration set formation process. The reason I make this assumption is that searchers often see the same listing at different rank positions depending on the filters applied. Therefore, I assume that searchers are at least aware of the listings that are displayed on each page. However, any preference for something that is shown first as opposed to tenth on the page is captured by the error term in the utility function. Second, I assume that the consideration set formation process does not change with the ranking algorithm. This is a reasonable approximation if searchers believe that the ranking algorithm always gives the most relevant results according to Airbnb, regardless of what the actual algorithm is. However, to the extent that better ranking algorithms encourage marginal searchers to increase the amount of pages they browse, I am likely to be understating the positive effects of better ranking algorithms in my

simulations.

I am also not estimating a model of the optimal choice to use a filter or browse a set of options (as in Chen and Yao [7]). Such a model would be able to identify search costs, which are not the focus of this paper. However, it would be complex and the parameters in such a model would be identified off of assumptions about the expectations of searchers. The rational expectations assumption used to identify search costs will not hold on Airbnb because most searchers are not experienced with city specific housing markets and have no way to know how the supply of listings on Airbnb would change if they wait. Koulayev [18] uses a rational expectations approach to estimate a model of search engine usage for a large hotel search engine. He estimates a median search cost of \$10 per page of results. Given that searchers in my sample view a median of 7 pages, that estimate would imply a median incurred search costs of \$70, with a significant left tail of individuals incurring hundreds of dollars of costs. These costs are unreasonably high given that the cost of booking a room is often less than \$100 per night. One promising approach for future research is to model the process of learning during search as in Koulayev [19] and Santos et al. [27].

### 3.2 Directed Search and Preferences

The guest’s choice of which property to contact from a given consideration set is determined by a random utility discrete choice model. The property characteristics visible in search results are price, location, number of reviews, property type and any common social connections between the guest and host. Other characteristics, which are visible upon further inspection, include additional pictures of the property, a free form textual description of the property, the text of listing reviews, a description of the host, average response time, average response rate, frequency of calendar update, security deposit, bedrooms, bathrooms and cancellation policies. The searcher evaluates these characteristics and chooses one (or more) properties to contact.

Let guest,  $g$ , enter the market at time,  $t$ . Each guest searches for a property to apply to from a consideration set. The guest receives utility from property,  $h$ , according to a linear combination of property characteristics, a property random effect and a guest specific error term according to the equation below:

$$u_{ght} = \alpha_0 + (p_{ght} + f_{ght})(FP'_g\alpha_1 + Z'_g\alpha_2) + f(X_{ht}, Z_g)'\beta_1 + \kappa_N + NF_{gh} + RF_{gh} + \gamma_h + \epsilon_{ght} \quad (3)$$

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<sup>18</sup>There is a growing literature that examines the effect of the search order on advertising clicks, movie viewing decisions, and other search behavior (Ghose and Yang [11] and Jeziorski and Segal [16]).

where  $X_{ht}$  is a vector of property characteristics including review quality, property type and whether the host is a property manager.  $Z_g$  is a vector of trip and guest characteristics (Nights, Age, Guests),  $FP_g$  is a set of categorical variables that measure the maximum price filter used by the searcher,  $f(X_{ht}, Z_g)$  is a set of interactions between guest and host characteristics,  $p_{ht}$  is the nightly price of the property for the trip,  $f_{ght}$  is the platform fee,  $\kappa_N$  is a neighborhood fixed effect,  $NF_{gh}$  is an indicator variable for whether a listing's neighborhood was specified by a searcher's filter (or map action),  $RF_{gh}$  is an indicator variable for whether a listing's room type was specified by a searcher's filter and  $\eta_{ght}$  is an unobserved component of the utility which is distributed according to the type 1 Extreme Value (EV) distribution with variance 1.  $\gamma_h$  is a normally distributed listing level random effect. The random effect is included to account for unobserved heterogeneity at the listing level. Furthermore, this demand model allows for heterogeneity in searcher preferences about location, price and the size of the listing. Searcher heterogeneity is modeled using interactions of listing characteristics with searcher characteristics and filters used.

The searcher can also choose to take the outside option and leave the online marketplace. The searcher's value of the outside option is determined by the following equation:

$$u_{got} = T'_g \mu + HP_t * FP_g + \alpha \log(H_{gt}) + \epsilon_{got} \quad (4)$$

where  $T_g$  are guest and trip characteristics,  $HP_t$  is the average hotel price for the city on the date of check-in,  $FP_g$  is a set of categorical variables that measure the maximum price filter used by the searcher,  $H_{gt}$  is the number of listings in a guest's consideration set and  $\epsilon_{got}$  is a type 1 EV error term.

The probability of making a choice between a particular property and the outside option is determined by the relative utilities of the two options, search costs, the continuation value of searching and the probability of booking a particular inquiry. Suppose that a searcher can only send an inquiry to one listing. The probability that a searcher sends an inquiry to property, h, as opposed to choosing the outside option is determined by the following equation:

$$Pr(u_{go} < b_{gh}u_{gh} + (1 - b_{gh})u_{go} - c) = Pr(u_{go} + \frac{c}{b_{gh}} < u_{gh}) \quad (5)$$

where  $b_{gh}$  is the perceived probability that searcher, g, books property, h, and c is the cost of sending an inquiry.<sup>19</sup> In reality, there is a continuation value of sending an inquiry that is likely to be higher than the value of the outside option because some searchers do send more than one inquiry. Let  $b'_{gh}$  be the rate with which a searcher books any listing on Airbnb and suppose that any listing which the searcher books has equivalent value to the

first listing which the guest sent an inquiry to. The searcher’s decision problem is then:

$$Pr(u_{go} < b'_{gh}u_{gh} + (1 - b'_{gh})u_{go} - c) = Pr(u_{go} + \frac{c}{b'_{gh}} < u_{gh}) \quad (6)$$

In either case, the consumer surplus in the above model depends on the value of the outside option and the magnitude of the effective search cost,  $\frac{c}{b'_{gh}}$ . The effective search cost is difficult to identify without making strong assumptions because it is unclear how searchers’ expectations of booking probabilities are formed. The reason is that searchers on Airbnb typically have little experience with using the site and rejection rates are not publicly disclosed.<sup>20</sup> The above two assumptions about  $b_{gh}$  have a small effect on the quantitative results because the calibrated search cost parameter is small relative to the benefit of booking a room.

The demand estimation procedure requires assumptions about the empirical analogue to the consideration set of each searcher. Consider the case when a searcher sees a set of listings in the first browsing session and immediately sends an inquiry. The consideration set for that scenario is composed of all the listings seen in that browsing session. In other cases a guest sends an inquiry after many days of search for a particular trip. Some properties that the guest browsed could have been booked by someone else before the decision to send an inquiry was made. Lastly, guests sometimes send an inquiry to a host without seeing a property in the search results. This might occur if the guest navigated to the property through an outside link.

I include a property in the consideration set used for estimation of the demand model if the guest saw the property and sent an inquiry to any property up to 2 days afterward. If a guest did not send an inquiry, then I include a property if it was seen in the last 2 days of search. Guests who sent an inquiry more than two days after the last search, who sent an inquiry to a property that was not observed in search or who viewed fewer than 21 total listings are excluded. I make the above assumptions so that the estimation data contains only decisions that mirror the underlying model of behavior. Lastly, I limit the sample to those searchers that used a neighborhood filter or map at least once. The reason for this is that I want to allow for the fact that searchers have idiosyncratic preferences towards specific locations and express them using filters. The location specific preferences of searchers who did not use a neighborhood filter or map are unobserved by me although they likely exit

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<sup>19</sup>The cost of sending an inquiry should be thought of as the cost of writing a short message to the host or entering credit card information. This cost is distinct from the “search costs” incurred while browsing, which are the focus of Koulayev [18]

<sup>20</sup>In some other matching markets, such as college admissions, there is public information on option specific admissions rates which may cause searchers to behave differently.

nonetheless and are important in determining searcher decisions.

The variation in consideration sets provides the identification in the model. Due to complicated supply and demand dynamics, the amount and quality of listings available in the market varies both by the week of the trip and the week of the search. Therefore, searchers who enter the market at a given time before a trip might see very different listings depending on the week of the trip.<sup>21</sup> This variation allows me to identify how the value of the outside option for searchers varies both by the week of the trip and the time in advance of the trip that the search occurred.

No matter how many covariates are added to the model, there will still be important aspects of the property characteristics that are difficult to observe by the econometrician but not by the guest. For example, the property may have stylish furniture in the picture. Such a listing is likely to charge a higher price than an otherwise similar property with worse furniture. I evaluate the robustness of my results to this bias in a forthcoming appendix which varies the magnitude of the coefficient on price and reruns the subsequent analysis in the paper.

Another complication with the above specification is that random utility models overstate the benefits to variety because the characteristic space expands with every product. In practice, products crowd each other out to some extent in the characteristic space. My results are robust to adding a correction term ( as in Akerberg and Rysman [1]) for the size of the consideration set.<sup>22</sup>

### 3.2.1 Demand Estimation

The estimation sample consists of 8,977 users with Airbnb accounts searching in City X between March 30, 2013 to June 25, 2013 for trips between April 2013 through July 2013. These users collectively viewed a total of 569 thousand listings while searching.<sup>23</sup> Searchers who only had 1 search were also excluded from the sample to reduce noise. Less than 1% of those searchers actually contact a host and these searchers are typically viewed as “non-serious” by analysts within the company. I also exclude those searchers who saw fewer than 21 or more than 500 properties because such observations are either incomplete or likely driven by bots.

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<sup>21</sup>In some cases, such as the Super Bowl, searchers might strategically time entry. However, the market I study does not experience such major events.

<sup>22</sup>Such a term corrects for the tendency of the utility from a random utility choice to diverge as the set of options grows. The correction suffers from bias if those individuals who view larger consideration sets conditional on observed characteristics also value the outside option differently than those who view smaller consideration sets.

<sup>23</sup>To be included in the sample, searchers had to have fewer than 9 guests, fewer than 15 nights of stay and must have searched before the day of the check-in. I also exclude views of “Shared” rooms which comprise



The estimates from the demand model for listing and outside option characteristics are displayed in [Table 4](#) and [Table 5](#) respectively. In both tables, Column 1 is the specification without random effects and Column 2 is the specification with random effects. Each coefficient estimate and standard error is normalized by the coefficient on price for those individuals whose highest maximum price filter during search was between \$10 and \$100.

Across specifications, guests value higher rated listings, better locations, and listings that fulfill filter criteria. Furthermore, there is significant searcher heterogeneity in the price sensitivity depending on the searchers' use of price filters. Trips with more guests are less price sensitive and value entire properties as opposed to private rooms. Older guests are less price sensitive, presumably because they are richer.

The value of the outside option (inclusive of effective search costs) compared to the value of a listing is important for counterfactuals because policy changes affect the set of listings that people see. If the listings shown are better, then the searcher should be less likely to choose the outside option. One very important factor determining the value of the outside option is the price of a hotel for the dates of the trip. The estimation results show that all types of searchers are less likely to choose the outside option when hotel prices are high. Furthermore, those searchers that use more stringent price filters are more sensitive to hotel prices. Lastly, those individuals that browse the most pages are least likely to pick the outside option. This term captures the fact that those individuals for whom the outside option is the worst, have the most to gain from searching intensively on Airbnb.

The standard deviation of listing random effects, which account for the listing level heterogeneity conditional on observables is \$8. The random effect is on the same order as having a maximum rating of 5 stars versus a mediocre rating of 4.5 stars. Therefore, there is still significant heterogeneity between listings conditional on observables. The standard deviation of the utility error term ranges between \$17 and \$19 per night. The unexplained component of utility is important because it often takes on values that are much larger than the values of observable listing characteristics. The error term is driven by the fact that characteristics which are observable to searcher (photo quality, amenities, etc...) are not included in the specification. Further, the error term can be inflated by unobserved preference heterogeneity and the fact the searchers may not scroll all the way through any given set of 21 results on the search page.

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< 1% of all inquiries.

### 3.3 Simultaneous and Sequential Search

Some searchers send multiple initial inquiries and continue search after they are rejected. The propensity of searchers to engage in intensive search is a function of their characteristics. For example, individuals who have successfully used the site before are more likely to continue search after an initial rejection. I estimate Poisson count of models of the number of inquiries sent initially and after rejection (shown in [Table 5](#)). For simultaneous search, the number of inquiries initially sent by a searcher minus 1 is regressed on trip and searcher characteristics. For sequential search, the number of subsequent inquiries is regressed on trip and searcher characteristics. In the simulation, the potential number of inquiries a searcher is willing to send is limited by the amount of listings in the consideration set which are better than the outside option. Therefore, I calibrate adjustment parameters which inflate the mean number of potential inquiries that a searcher would like to send. These adjustments allow the simulation to match the rates of sequential and simultaneous search in the data.

## 4 Rejection and Screening

Hosts receiving inquiries from potential guests choose which of them to accept or reject. In the model, each host evaluates inquiries in sequence based on guest and trip characteristics.<sup>24</sup> If an inquiry is suitable, the host responds with a non-rejection and waits for the guest to eventually book. If the inquiry is not suitable, the host rejects and waits for the next inquiry. If the guest is not rejected and agrees to book, then the host rejects subsequent inquiries until the initial guest books.

There are three reasons why hosts reject guests in my model: congestion, “stale” vacancies and screening.<sup>25</sup> Congestion occurs when a guest sends an inquiry to a host who is about to transact with someone else. Transactions take time to clear because there is almost always some time between a communication and transaction on Airbnb. This gap happens because the guest takes time to return to the site after a response and enter the credit card information. Further, there are sometimes further details being discussed even after the first response by a host. I classify inquiries to hosts which are subsequently booked by a previously contacting guest as congestion. Not all congested inquiries receive an immediate rejection. Instead, the host may tell the guest to wait until there is a response from the previous inquiry. Congestion occurs for 5.6% of inquiries in the US for 2012.

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<sup>24</sup>In practice, there are some cases when a host receives inquiries in parallel. For example, a host might receive several inquiries at a time if he checks Airbnb infrequently. I abstract from this scenario because many hosts are notified by text or email of an inquiry and have an incentive to respond quickly. In other search markets, such as college admissions, a parallel model of decision making by the seller is more appropriate.

<sup>25</sup>[Appendix C](#) contains a static urn and ball model which demonstrates how rejections arise according to

A second type of rejection occurs because hosts are not available to anyone for a set of dates. There are two ways in which stale listings manifest themselves in the data. First, hosts can update their calendars to state that they are unavailable for a set of dates. For 56% of host-weeks in the sample, hosts update their calendars to be unavailable and are not booked by anyone for that week. For these stale vacancies to matter, hosts must update at a point when searchers are active in the market. In fact, many properties update their calendar more than 2 months ahead of the check-in date, so that few searchers have time to see the stale vacancies. In the data, 21% of all inquiries are sent to listings that are later updated to be unavailable for at least one of the dates of an inquiry and are not booked for any of the other dates of inquiry.

Some hosts with stale vacancies never update their calendar. This happens because updating the calendar is costly, because the host wants to learn information about demand or because the host forgets. Stale vacancies without calendar updates result in observations in which a host rejects all inquiries for a particular set of dates. [Figure 7](#) shows the distribution of rejection rates (excluding congested inquiries and those for which a host updated her calendar) by hosts in a given week of check-in if the host received at least 5 inquiries for that week. There is a wide dispersion of rejection rates and a noticeable excess mass at 1, with over 10% of host-week combinations rejecting all inquiries. However, nothing in the data determines whether a particular host rejected all inquiries due to actual unavailability or due to high selectivity. If hosts reject each inquiry at a rate of 50%, then there should be fewer than 3% of host-week combinations that reject all inquiries. At least some of the cases in which a host rejects everyone are probably due to stale vacancies. The upper bound for inquiries rejected due to unavailability includes all inquiries to hosts who reject all inquiries for a particular week. The lower bound is the set of all inquiries to hosts who eventually update their calendar to be unavailable. In total, the upper bound on inquiries rejected due to stale vacancies is 32% and the lower bound is 21%.<sup>26</sup>

Lastly, hosts reject because they are screening out unsuitable guests. [Figure 8](#) displays a histogram of the mean rejection rates (excluding congested inquiries) by property for all of 2012, conditional on a property receiving at least 10 inquiries. I exclude congested inquiries and inquiries to hosts who eventually updated their calendar to be unavailable. Many properties reject all or almost all inquiries while others accept almost everyone. The heterogeneity occurs because some properties are either more selective, more in demand, receive different types of inquiries or are more likely to not update their calendar than

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congestion, stale vacancies and screening.

<sup>26</sup>I've also estimated an explicit model that allows me to identify the share of inquiries rejected by screening versus stale vacancies. That model determines that 5.1% of inquiries are affected by stale vacancies for which hosts never updated their calendar.

others. Many of the listings that rejected close to 100% of inquiries rarely even responded and were eventually removed from the website. The remaining inquiries are rejected either due to screening or due to hosts who do not update their calendar. An upper bound on screening rejections includes those cases in which hosts rejected all inquiries in for a given week of trip while the lower bound does not. The upper bound on immediate rejections due to screening as a share of all inquiries is 31% while the lower bound is 20% in 2012.

Stale listings and screening account for most of the rejections that occur on Airbnb. These two frictions are approximately the same magnitude and their importance depends on assumptions. On the other hand, congestion, which has been a key focus in many theoretical models of directed search, is a lot less important. In total, 59% of inquiries are affected by frictions either through screening, congestion or a stale vacancy. If search costs are large, then these results already suggest that there are large welfare costs of search frictions. Rejection also has a large impact on eventual booking probability. Table 3 regresses the probability of booking on whether the first inquiry a guest sent was rejected. A first rejection reduces overall booking probabilities by 50%.

There are some ambiguities in the classification. Listings that update their calendar to be unavailable might have been booked had a good enough offer come along early enough. Alternatively, they may have been booked off of the Airbnb platform.<sup>27</sup> There is no good data on how often hosts multi-home in several accommodations marketplaces but this type of behavior may be important for the counterfactuals (i.e. Athey et al. [3]). Another cause of error is that the text classification process is not fully accurate and could have mislabeled some responses. Lastly, some screening occurs later in the conversation and is not captured by my methodology.

## 4.1 Screening Model

Screening occurs on Airbnb because hosts have preferences over when and whom they host.<sup>28</sup> For example, a host might reject a guest because the guest is not reviewed, has a vague inquiry, or does not have enough information in his profile. Hosts also reject guests because the check-in dates of the inquiry can break up a bigger, uninterrupted time of availability

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<sup>26</sup>Horton [14] finds similar sized effects for rejections on Odesk

<sup>27</sup>In some cases, hosts indicate on their calendar that they were booked on another site. 1.81% of inquiries are sent to these hosts. There is no good evidence at Airbnb on how frequently transactions initiated on Airbnb are taken off of the platform. There are large incentives for guests and hosts to keep transactions online because of the insurance, reputation and secure monetary transfer that Airbnb offers.

<sup>28</sup>Bargaining plays a key role in other matching models with transferable utility between the two sides of the market. Bargaining is not prevalent on Airbnb. One reason might be that guests who ask for a discount seem less trustworthy and are perceived to be more of a hassle. The potential cost to a host from a non-trustworthy guest is perceived to be much greater than the potential earnings from the stay.

for the host, preventing future inquiries. Lastly, hosts may be waiting for a better guest/trip combination or might consider a particular inquiry too much of a hassle.<sup>29</sup>

I model the probability that a seller rejects a searcher as a logistic function of guest characteristics, trip characteristics, seller characteristics and market demand. The estimating equation is:

$$Pr(R_{gh}) = Pr(\alpha_0 + Z'_h\delta + f(X_g, Z_h)'\beta + \gamma_h + \eta_{gh} > 0) \quad (7)$$

where  $\eta_{gh}$  is the logit error term,  $R_{gh}$  is an indicator for whether the response is a rejection,  $X_g$  are the number of guests, guest reviews, guest gender, weekly demand, days in advance of the trip nights, guest age, searcher census tract demographics and month of check-in.  $Z_h$  are property type, property manager indicator, host age, the number of reviews and price.  $f(X_g, Z_h)$  are interactions between guest and listing characteristics.  $\gamma_h \sim N(0, \sigma_{sh}^2)$  represent listing specific random effects. The listing random effects account for heterogeneity in hosts' baseline propensity to reject. I account for the dynamic aspects of the host decision by controlling for the time in advance of the trip of inquiry and for the overall demand for each week of check-in. Nonetheless, the above model is incomplete because although it captures the decisions of hosts, it cannot be interpreted as a utility. In order to infer the utility of hosts, I would need to estimate a full structural model of host decision making with dynamic decisions driven by host expectations of future demand.

The potential dataset for estimation consists of all non-foreign language inquiries sent by guests in City X between January 2013 and July 2013. Each inquiry is then classified as a rejection according the procedure outlined in [subsection 2.4](#). I exclude inquiries in which congestion occurred and in which the host updated her calendar for the inquiry dates after the inquiry to indicate unavailability. The final dataset consists of 18145 observations of which 44% were rejected. I include cases in which the host rejected all inquiries, assuming for the case of the simulation that cases when the host rejected all inquiries for a week was due to screening.

Table 6, panels a - c, displays the results of specifications with and without hosting and guest specific random effects. Less "trustworthy" guests and inquiries which require more hassle such as last minute and short stays should be rejected more often. Panel (a) displays the coefficients on trip and guest characteristics of inquiries. Reviewed guests are less likely to be rejected, presumably because hosts find them more trustworthy. Trips with more nights are less likely to be rejected as long as they are not too long. Market conditions also matter for rejection behavior. In the specification with random effects, the standard deviation of the propensity of hosts to reject is large compared to the coefficients. This confirms the analysis

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<sup>29</sup>The above reasons are frequently stated by hosts in internal Airbnb surveys. They are corroborated by the screening model estimates.

in [subsection 4.1](#) which indicates that some hosts are a lot more selective than others.

Panel (b) displays the coefficients on host characteristics in the regression. Hosts that tend to respond quickly or allow instant booking are less likely to reject. On the other hand, younger hosts, female hosts, and hosts with entire properties are more likely to reject guests. Property managers (hosts with more than 4 active listings) are less likely to reject because they care less about interacting with guests and operate more like hotels. The interaction between certain types of hosts and certain types of guests is important because it potentially generates mismatch in equilibrium. For example, some types of guests may really like some types of hosts but the hosts could be indifferent between the two types. In that case, a decentralized matching process potentially results in a suboptimal match. Panel (c) displays the coefficients on interactions between guest and host characteristics. Property managers are also more likely to reject reviewed guests because they care less about interacting with the guest. Furthermore, property managers are less likely to reject last minute inquiries than non-property managers because it is easier for property managers get a listing ready for a stay on short notice. The screening model demonstrates that there are predictable conditions under which inquiries are likely to be good matches with hosts. Therefore, it should be possible to use this model to derive policies which direct searchers to hosts who are willing to transact.

## 5 Simulation of Equilibrium Outcomes

In this section I describe how to combine the search and screening models into a model of market equilibrium. The goal of the model is to generate market level matching outcomes from micro-foundations. My approach is similar to Roth and Xing [25], which studies congestion in the clinical psychologist market with simulation. I improve on that paper’s approach by estimating preferences from the data, by modeling multiple frictions and by comparing model outcomes to empirical moments. An alternative way to condition the model on the data would be to estimate rather than simulate all of the parameters. I chose to simulate because most of the calibrated parameters in the simulation have close empirical analogues in the data and because simulation is faster than estimation.

### 5.1 Simulation Setup

For a given check-in week in City X, I observe searchers, bookers, and listings. I collapse the 7 days of the week being modeled into 1 time period and assume that each listing can only be booked once per week.<sup>30</sup> Every searcher who enters the market looking to stay in City X

for the week of the simulation draws a consideration set, receives a mean utility from every listing in the market and draws a random utility shock distributed according to the demand estimates from column (2) of Table 4. Similarly, each listing receives a mean probability and a random error term conditional on searcher and listing characteristics from the logit model of rejection in column (1) of Table 6. Listing that updated their calendar at a given time in the data are visible to searchers who enter before that time in the simulation. The same process is repeated for each subsequent searcher in the data.

The simulation requires several additional parameters related to market clearing and the intensity of sequential and simultaneous inquiries. All of the calibrated parameters are seen in Table 6. The time to transact is determined according to an exponential distribution whose mean is the empirical mean of time to transact in the data. I assume that the time between browsing and sending an inquiry is negligible. There are two parameters in the model that do not have direct analogues in the data:  $\mu_{sim}$ , and  $\mu_{seq}$ , which determine the extent of simultaneous (initial) and sequential search.

The amount of initial inquiries sent by a searcher is determined as follows. Each searcher draws a random Poisson variable,  $n_{sim}$  with mean equal to the product of the predicted mean from the Poisson regression in subsection 3.3 and a calibrated constant,  $\mu_{sim} > 1$ . The searcher then sends inquiries to the minimum of either  $n_{sim} + 1$  or the number of viewed listings with utility greater than the outside option. Sequential search is treated in the same manner. A searcher who is rejected draws a Poisson random variable,  $n_{seq}$ , according to the expected mean from the Poisson regression multiplied by  $\mu_{seq} > 1$ . A draw of 0 implies that the searcher does not continue search. If the draw is greater than 0, then the searcher comes back to the market 1 day later and sees the entire choice set. The searcher then sends an inquiry to the minimum of  $n_{seq}$  and the number of properties remaining which are better than the outside option. I choose values of  $\mu_{sim}$ , and  $\mu_{seq}$  that match the rates of simultaneous and sequential inquiries using a grid search over parameter values.

Approximately 17% of the time, a transaction does not occur even if there is no immediate rejection. This event can occur because the guest does want to book the place, the host ends up rejecting the guest later in the conversation, or because the initial classification was wrong. In the simulation, I assume guests leave the market with a constant probability after a non-rejection.

The calibrated parameters described above are sufficient to simulate market outcomes.

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<sup>30</sup>In the data, 22% of hosts who receive an at least one inquiry in a week book more than 1 trip in that week. I avoid modeling this behavior because the model fits the data and accounting for multiple bookings adds complexity to the model. If a guest is looking for a stay of more than 7 days, then only the 7 days are used for the calculation of surplus and revenue in this section. Otherwise trips that cross into other weeks would affect outcomes for the simulation week.



However, several additional assumptions need to be made in order to calculate consumer surplus. Firstly, searchers experience costs while browsing the website and send inquiries. I calibrate these search costs by using data on the time spent searching and combining it with the shadow value of time for searchers. Specifically, assume that each inquiry takes 5 minutes to compose and that it takes approximately .725 minutes to browse a page. Furthermore, suppose that Airbnb users earn twice as much as the median annual income for males aged 25 - 44 in the United States.<sup>31</sup> If searchers work two thousand hours a year then the shadow value of time will be \$3.24 per 5 minutes. I use this search cost for the rest of the simulation exercises. Lastly, I assume that searchers expect their booking probability to be the average probability of any inquiry resulting in a booking. The assumption is justified if searchers' continuation value of searching after an inquiry that is rejected is equal to the value of the outside option. Alternative assumptions on the expectation make little difference for consumer surplus because the costs of sending an inquiry are low relative to the benefit of booking a room.<sup>32</sup>

## 5.2 Baseline Results

The final choice situation includes 960 searchers and 1159 visible listings (56 days in advance of the check-in dates). Table 7 row (1) displays the outcomes that occurred in the data for the choice situation. 62% of searchers sent an inquiry and 37% eventually booked a room. Note, these percentages are very sensitive to the measured number of searchers and listings in the data. However, this measurement, especially for searchers, depends on what constitutes a searcher. In this paper, I count anyone that does more than 1 search with dates and has an associated user id as a searcher. However, to the extent that some other, non-included searchers may be influenced by the policy, the exact results will change. I test how the relative ratio of searchers and hosts affects outcomes in ???. In comparison, row 2 displays the results of the baseline simulation. The model outcomes match the data well considering that most of the moments in the table were not explicitly targeted by the calibration. The most significant differences between the data and simulation is that simulation overstates the revenue of hosts by \$23.<sup>33</sup>

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<sup>31</sup>Source: U.S. Census Bureau, Current Population Survey, 2013 Annual Social and Economic Supplement.

<sup>32</sup>I assume that individuals don't choose whom they send inquiries to depending on their idiosyncratic probability of rejection. This assumption is justified by the fact that most searchers do not have enough experience with the platform to know their rejection probabilities. Furthermore, there is little information on the platform about the relative likelihood that a particular host is more selective than another host.

<sup>33</sup>The share of searchers that books is likely to be understated in the simulation because, in the data, some listings can actually be booked two or more times in a given week. For example, there can be one two night stay and another three night stay for a given listing.

### 5.3 Which Frictions Matter?

There are three mechanisms (excluding incurred search costs) by which actual market outcomes differ from the solution to the social planner’s problem: rejection, limited choice sets and dynamic mis-allocation<sup>34</sup>. Table 7 displays moments for cases in which rejection and limited choice sets are individually and jointly removed.<sup>35</sup> First consider row (7), in which all listings that would reject each searcher are removed from that searcher’s choice set. Compared to the baseline simulation, removing rejecting hosts decreases inquiries by searchers because on average, worse quality listings are shown. However, the inquiries that are sent are much more effective. Without rejections, the share of searchers booking increases by 38%, the average revenue increases by \$46 per searcher and the average consumer surplus increases by \$15 per searcher. This is a large and surprising impact given the limited supply available on the platform. The improvement in matching indicates that there are suitable substitutes for rejecting properties on the platform, but that those properties are not being contacted at a high enough rate.

In rows (3) - (5) of 7, I display the equilibrium effect of each rejection cause separately. Of all rejection frictions, screening has the largest effect on booking and consumer surplus. The effect of screening in equilibrium is larger than it’s frequency in the data because screening properties are more likely to be included in searchers’ consideration sets and are more desirable for searchers. Further, listings that screened a particular guest might have accepted another one, whereas stale listings and congested listings could not have matched with another searcher. The importance of screening suggests that Airbnb should guide guests towards hosts that are willing to transact. Secondly, Airbnb should elicit host preferences about guests ahead of time to improve Airbnb’s ability to guide the guest’s search.

Row (6) of Table 7 displays the simulated matching outcomes if searchers freely considered all listed properties rather than just a limited consideration set. The share of searchers that book increases by 54% and the revenue per searcher increases by 59\$. The effect of limited consideration sets is bigger than the cumulative effect of all rejection reasons because there are large product specific error terms. Row (8) displays the results of the simulation if the rejection friction and the partially observed choice sets were removed together. There is a 95% increase in booking probabilities from having both frictions eliminated at once,

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<sup>34</sup>I do not have results on dynamic mis-allocation for this model yet. In the previous version of the paper dynamic mis-allocation was a small friction.

<sup>35</sup>In the counterfactual exercises, the searcher’s expected probability of transacting given an inquiry should change. However, in the results below they do not. I will implement the correction in the future but doubt that such a correction would make much of a difference. Even if the expected booking probability per inquiry increases to 50%, the added benefit would be less than 10\$

which is approximately equal to the sum of the gains from removing rejections and partial consideration sets separately.

The counterfactual with full consideration sets abstracts away from the fact that considering hundreds of properties takes significant time and effort. However, the time spent to view and consider all listings would be significant. The mean time spent in search by a searcher who sends an inquiry is 18 minutes and even those searchers do not typically consider all visible listings in the market. In order to compute the costs of browsing for these counterfactual scenarios, I assume that it takes 90 minutes to consider all available properties. Furthermore, as in the other counterfactuals, guests value each 5 minutes of time at \$3.24. Therefore, the average costs of browsing all listings would be \$58 per searcher. This is actually very close to the surplus gain per searcher of having consideration sets. Column (5) of [Table 7](#) shows the average consumer surplus including the browsing costs for each outcome. The increase in consumer surplus from seeing the full consideration set is only \$5 although the increase in booking probabilities is 20 percentage points. Therefore, although the potential gains to finding the best match are high, the costs of considering all options make those gains small. However, if the platform can predict what the best match for a searcher is without the searcher engaging in costly search, the gains remain high.

## 5.4 Marketplace Policy

I have shown that search frictions significantly affect consumer surplus and revenue on Airbnb. Because even small changes in conversion rates can improve profit margins, the platform should actively be aiming to reduce frictions. One way in which the platform can improve outcomes is by changing the order in which items are displayed in the marketplace. In my model, as in Dinerstein et al. [\[9\]](#), this corresponds to changing the ranking algorithm used for consideration set formation.

In this section I consider three ranking algorithms whose goal is to improve market efficiency by showing more relevant listings to searchers. I simulate the effects of better algorithms by deriving a counterfactual listing specific weight,  $w_h$ , and using it to determine the ranking of listings in search. Let  $\bar{\mu}_{gh}$  equal the deterministic part of searcher utility:

$$\bar{\mu}_{gh} = \alpha_0 + (p_{ght} + f_{ght})(1(FP \in [10, 100])) * \alpha_{1,10} + Z'_g \alpha_2 + f(X_{ht}, Z_g)' \beta_1 + \kappa_N + \gamma_h + \epsilon_{ght} \quad (8)$$

Where the price elasticity is set assuming that searcher  $g$  is the type that would set the

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<sup>35</sup>Much of the research on search and recommendation engines focuses on search for content or non-capacity constrained goods (i.e. Amazon Books). However, when the supply of a given good is capped, one buyer of a good prevents other searchers from buying that good. The preferences of searchers entering the market over time and the consideration sets they draw determine whether the good is allocated in an optimal manner.

price filter between \$10 - \$100.

Three weights for the algorithms are as follows:

1.  $w_h = \sum_g \bar{\mu}_{gh}$  (Average Quality)
2.  $w_{gh} = \bar{\mu}_{gh}$  (Personalized Quality)
3.  $w_{gh} = F^{-1}(\bar{\mu}_{gh} - \bar{\mu}_{go}) * (1 - Pr(R_{gh}))$  (Transaction Probability)

The first ranking algorithm is calculated by averaging  $\bar{\mu}_{gh}$  across searchers for each listing. This type of algorithm would be appropriate if the marketplace cannot generate personalized search results. The second algorithm generates a personalized ranking based on the average utility of a searcher for a specific listing. The third algorithm is also personalized but shows listings that searchers are more likely to transact with. In the weight (3),  $F^{-1}$  is the inverse logistic distribution,  $\bar{\mu}_{go}$  is the mean value of the outside option and  $Pr(R_{gh})$  is the probability that host  $h$  rejects guest  $g$ .

Table 7 rows (9) - (11) show the results of these policies in order. The non-personalized search algorithm increases contact rates by 13% and booking rates by 2.5% compared to the baseline and the personalized search algorithms increase the share of searchers contacting by 18% and the booking rates by 10%. All algorithms increase consumer surplus but, as expected, the personalized algorithm results in a larger surplus gain than the non-personalized algorithm. The non-personalized algorithm actually decreases revenue, perhaps by steering searchers to cheaper properties. However, the personalized algorithms increase revenue by approximately \$7 per searcher, a significant amount for the platform.

The demand models I use to generate the ranking algorithms do not explain a large share of searcher choice. In practice, market designers can choose how much employee time and resources to devote to generating features from data and better prediction algorithms that use those features. The increase in bookings in the counterfactual where searchers see the full choice set suggests that there are high returns to devoting resources to building better demand models.

## 5.5 Experimentation

Internet companies typically run user level experiments to learn about the effects of policies. For example, a company may test a new feature by allowing 50% of users to see it and comparing average outcomes between the treatment and control group. These tests typically yield useful information about the effect of a policy on behavior. However, in the marketplace setting, the treatment effects typically affects the control. For example, if there is a finite number of sellers in the market, a treatment which improves matching, may reduce the set

of options for the control. In other cases, if ranking algorithm results are correlated across searchers, adversely selected properties stay in the the search results for more searchers in the full treatment as apposed to the A/B treatment. In general, the effect of partial treatment roll-out and a full treatment roll-out in the marketplace are different. <sup>36</sup>

The size of the bias due to this test-control interference depends on market conditions. This is precisely the reason why structural models of market outcomes are useful for designing marketplaces policy. In this section, I simulate the difference between estimated treatment effects from an A/B test and the overall market level effect of a treatment. To do this, I assign 50% of the searchers in the simulation to the non-personalized ranking algorithm and compute market outcomes.

Table 8 displays three types of treatment effects for two ranking algorithms. First consider columns 1 - 3, which show outcomes for the non-personalized quality algorithm. Column (1) shows the measured treatment effects from an A/B test. Here the share of searchers booking increases by 5.5% in the treatment versus the control. Column (2) shows the difference in outcomes if everyone in the market were to be given the treatment. The overall effect on booking is an increase of 2.5%. Therefore, for this week and market, the A/B test overstates the true treatment effect of the policy by 120%. Lastly, Column (3) shows the market level effect of launching the A/B test. Interestingly, the increase in booking probability due to the half rollout is 6.3% which is higher than both the A/B treatment effect and the true treatment effect. This seeming anomaly is due to the fact that the full-rollout increases the share of inquiries that are rejected due to congestion and stale vacancies much more than the half roll-out. Furthermore, the half-rollout actually slightly improves the outcomes of the control group because they are less likely to be rejected due to congestion.

Columns 4 - 6 display the same outcomes for the personalized quality algorithm. Here, the A/B results still overstate the true market level effects of the algorithm but the bias is much smaller for two reasons. First, the increase in rejections due to the personalized policy is only 13% while the the increase in rejections due to the non-personalized ranking algorithm is 18%. Second, because individuals in the non-personalized ranking algorithm get less relevant results, they send fewer inquiries and therefore each rejection lowers booking probabilities by a greater amount than in the personalized algorithm.

An alternative to simulation for estimating these treatment effects is to do market level experiments. However, market level experiments might not be feasible when market definitions are ambiguous, when there are few markets or when markets are not comparable.

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<sup>36</sup>For a similar effect in the labor market see Crepon et al. [8] on the difference between the partial and general equilibrium effects of a job counseling program in France. Another example is ? ] for email advertising on Ebay

Another option for measuring the equilibrium treatment effect is to combine models like the one in this paper with experimental results. A model of market equilibrium should have parameters that are influenced by an experiment. With experimental variation, I could estimate how an alternate ranking algorithm changes consideration set formation. The alternate consideration set model can then be used to simulate market outcomes. Importantly, such an approach does not require an exact replication of a complicated ranking algorithm within the model. What matters for outcomes is how the algorithm influences consideration set formation or other relevant features of the model. The equilibrium effects of other types of experimental interventions which change the rules of the market can be modeled in the same way.

## 5.6 Aggregate Matching Functions, Market Tightness and Policy

The setting of the prior simulations is one market and one week. However, market conditions vary on Airbnb both across markets and over time. In this section, I vary the ratio of searchers to hosts and the overall amount of agents in the market to study how market conditions affect matching and policy. By varying market conditions, I can obtain unbiased estimates of an aggregate matching function and to test for increasing returns to scale. Furthermore, I can show how aggregate matching functions change with marketplace policy.

I generate data to estimate a matching function by randomly subsampling or re-sampling agents in the market and simulating outcomes.<sup>37</sup> Each market condition is simulated 15 times, with the amount of listings and guests varying between 50% and 200% of the amount seen in the data. I use the simulated data to estimate a Cobb-Douglass matching function of the form:

$$\log(M_s) = \log(A) + \alpha \log(G_s) + \beta \log(H_s) + \epsilon_s \quad (9)$$

where  $M$  is the number of matches,  $G$  is the number of searchers and  $H$  is the number of listings in the market. [Table 9](#) displays the estimated results of this equation, where the coefficients are allowed to vary by the search algorithm used.

First of all, the coefficient on searchers,  $\alpha$ , is .805 while that on hosts,  $\beta$ , is .171. Therefore, the amount of searchers is a bigger contributor to the overall number of bookings than the amount of hosts. Unbiased matching function estimates for consider optimal advertising policies.<sup>38</sup> There are two forces that can cause matching on Airbnb to either exhibit increasing or decreasing returns to scale. Firstly, a market with more options should generate better matches on average because searchers can draw larger consideration sets and because those

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<sup>37</sup>I break ties in the timing of entry of searchers by adding a random exponential noise component with a mean of an hour to each realized entry time.

consideration sets will include better options on average. On the other hand, if consideration sets are highly correlated then thicker markets may exhibit higher levels of congestion and higher costs of adverse selection. The estimated returns to scale in the the matching function,  $\alpha + \beta$ , equals .976. Therefore, returns in this market are slightly decreasing in scale.

Furthermore, ranking algorithms change the shape of the aggregate matching function. I show this by simulating outcomes in the market with the personalized quality algorithm at different levels of tightness. The interacted coefficients in [Table 9](#) correspond to the matching function estimates when search rank is personalized. The improved ranking algorithm increases the share of matches due to the supply side in the market and decreases the share due to the demand side. The change in the shape of the matching function occurs because for each fixed quantity and quality of listings searchers are shown better options and are more likely to convert. However, as listings are booked, later searchers have worse options and are less likely to convert. The above exercise demonstrates why the Cobb-Douglas matching function parameters cannot be interpreted as structural.

Some aspects of agent behavior can change with market tightness and market size but are not in my model. For example, searchers might form bigger consideration sets if there are more listings to match with, which would result in greater returns to scale if congestion remains a small issue. On the other side of the market, hosts may change pricing and rejection strategies with market conditions, although the directional impact of these adjustments on matching is unclear a priori. Lastly, reputation capital might actually be the biggest cause of returns to scale in marketplaces (i.e. Paltas [22]). The matching function estimates above do not model the effects of market conditions on the accumulation of reputation capital. For example, the size and tightness of a market may determine how difficult it is for new listings to accumulate reputation.

## 6 Conclusion

The rate at which heterogeneous agents successfully transact and the surplus generated by those transactions is a function of the information structure of a market. I use novel data on search and communication behavior to build a micro-founded model of matching. The underlying cause of the matching frictions in the model is that guests and hosts have hetero-

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<sup>38</sup>Estimates of matching functions using cross-market and within-market data yield similar results, with  $\alpha = .869$  and  $\beta = .225$ . However, estimates based on observational data suffer from the fact that market level tightness may be a function of the market specific matching shocks. For example, in high-demand weeks searchers may be more willing to book worse Airbnb's due to the fact that hotel prices are higher. This source of endogeneity would likely bias the estimates of  $\alpha$  upward.



geneous preferences and must use communication and Airbnb’s site to obtain the necessary information to transact. Airbnb provides a review system, a communication platform and many other tools to reduce the cost of searching. Even with these tools, many searches fail and frictions combine to reduce transactions on the site.

Airbnb loses profit because frictions reduce the volume of transactions and overall revenue. Airbnb’s policy makers can use the data they observe about the history of both searcher and seller behavior to improve outcomes. In this paper, I simulate policies which use such data to improve the relevance of consideration sets and to reduce the chance that rejections occur. I find that better search ranking algorithms can improve transaction probabilities by 10%. These gains demonstrate that marketplace designers can generate large gains in volume, revenue and consumer surplus through better policy. As the marketplace designer’s knowledge about each agent’s preferences approaches the full information benchmark, outcomes approach their frictionless benchmark. The ongoing reduction in the costs of storing and analyzing data, commonly referred to as the “Big Data” revolution, will likely have a profound impact on platforms like Airbnb because more and better data can improve the platform’s estimates of agent preferences. Although I focus on ranking algorithm design in this paper, my modeling framework can be used for other unsolved problems in marketplace design such as optimal marketing strategies, price recommendations and platform fees. For example, in order to evaluate marketing strategies, platforms need to know the rate at which searchers and listings acquired by marketing channels cannibalize transactions from current market participants and the extent to which they extend the total volume of trade in the market. The simulations of market outcomes at alternate levels of tightness in the previous section explicitly model such effects.

The efficiency loss due to search frictions in other search and matching markets will vary depending on the expectations of searchers, the potential benefits of searching, the ranking algorithm, the market tightness, and the details of consideration set formation. Furthermore, specific platforms within each marketplace may face different incentives depending on their market power. For example, the cost of the rejection friction for the average searcher in the accommodations market is likely to be low because hotels typically clear the market based on price and do not explicitly reject potential guests. Because of competition from hotels, Airbnb has a strong incentive to reduce the rejection friction. In the labor and housing markets, however, rejection is common to most options. Therefore, the average costs from the rejection friction are likely to be higher than in the accommodations market. Furthermore, although individual platforms in these markets still have an incentive to reduce the rejection friction, that incentive may be diminished because searchers know that rejection is likely and adjust behavior accordingly. One example of such a market is college admissions, where

rejection rates are widely known by applicants.<sup>39</sup> Regardless of the exact structure of the market, structural models like the one in this paper can be used to design policy and to evaluate counterfactuals.

I only model short-run responses of agents to policy changes. In the long-run, however, policies will alter agents' market power and perception of matching probabilities.<sup>40</sup> Changes in market power will cause hosts to re-optimize their pricing and rejection strategies while changes in matching probabilities will lead guests to change how they send inquiries. Another type of adjustment might occur if the ranking algorithms can be manipulated by hosts. For example, if hosts know that the ranking algorithm favors listings with a particular amenity, they may either obtain that amenity or lie about having that amenity. The welfare and revenue implications of these endogenous adjustments are ambiguous. It will be interesting to see how online platforms deal with these long-run market dynamics.

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<sup>39</sup>However, even in the college admissions market, incomplete information about rejection matters. Hoxby and Avery [15] show that some high school students do not use widely available information on college admissions and financial aid to make application decisions.

<sup>40</sup>Rochet and Tirole [24] and Weyl [28] show how pricing and other policies affect the relative gains accrued by heterogeneous agents in a marketplace.

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## 7 Figures

Figure 1: Search View

Philadelphia, PA
01/02/2014
01/05/2014
2 Guests
SEARCH
LIST
PHOTO
MAP

☐ Redo search in map

Room type
Entire home/apt 226
Private room 289
Shared room 16
Show More...

Price
\$10 \$1000+

Connections
☐ Social Connections 16
Learn More!

Neighborhood
Center City 140
South Philadelphia 84
North Philadelphia 74
Rittenhouse Square 64
Show More...

Amenities
Wireless Internet 456
TV 282
Kitchen 410
Show More...

531 Rentals (Philadelphia) with 30 popular on Wish Lists
SHARE

1

**Rittenhouse Sq 1BR Apt w/Grdn Patio**  
Entire home/apt — Philadelphia > Center City  
99+ reviews

\$120  
Per night

2

**Convenient and Private Room in Home**  
Private room — Philadelphia > Mantua  
49 reviews

\$30  
Per night

3

**ART MUSEUM GARDEN 2**  
Private room — Philadelphia > Fairmount  
91 reviews 99+ other reviews

\$59  
Per night

4

**Amazing location 1bdr apartment**  
Entire home/apt — Philadelphia > Washington Square West  
23 reviews

\$110  
Per night

5

**Serene, quiet basement @ 9th & Pine**  
Private room — Philadelphia > Washington Square West  
90 reviews 1 other review

\$90  
Per night

6

**Loft Apt in Univ.City-USP,UPenn**  
Entire home/apt — Philadelphia > Kingsessing  
67 reviews

\$103  
Per night

7

**Bright Room Near Italian Market**  
Private room — Philadelphia > Passyunk Square  
56 reviews

\$62  
Per night

8

**Bright Studio in heart of OLD CITY!**  
Entire home/apt — Philadelphia > Old City  
9 reviews

\$110  
Per night

Above are the results of a search in Philadelphia for January 2, 2014 to January 5, 2014. Selecting filters or moving the map changes the set of displayed results. The searcher can scroll the page to see 21 listings before she is prompted to go to the next page of results.

Figure 2: Listing View

Photos
Maps
Street View
Calendar

Sunny Room in Queens & Brooklyn

Description
Amenities
House Rules

10 minutes to Williamsburg, 20 minutes to Manhattan!

A sunny private room with a Queen size futon and big closet in a new renovated apartment (this March), with a SHARED bathroom, has Wi-Fi, it's on the first floor, so no need to drag your heavy suitcase up down stairs.

the street is quite and safe, the building has it's own washer and dryer, (though we still need to pay, but we don't have to walk far to do the laundry),.

3 minutes walk to M train Seneca Stop, 6 minutes walk to L & M train Myrtle-Wyckoff stop.

the L & M both takes you to Manhattan in about 15 minutes ride, (than depends on where you are going to)

on the M train you can totally enjoy the sky ride, seeing Brooklyn views, takes you directly to the Central Park, MOMA, China Town, Queens, 5 Pointz (the amazing graffiti scene/blocks/gallery) etc.

the L train connects the most subway lines, hop on the L than very easy to switch to other places that you possibly wanna go to, also directly take you to Williamsburg, east village, Chelsea area, famous sky park - The High Line, and Rushwick (new area for underground)

Room type:	Private room
Bed type:	Futon
Accommodates:	2
Bedrooms:	1
Bathrooms:	1
Country:	United States
City:	Queens
Neighborhood:	Ridgewood
Cancellation:	Strict

From
Per Night

**\$43**

Check in
Check out
Guests

mm/dd/yyyy
mm/dd/yyyy
1

BOOK IT!

SAVE TO WISH LIST

Saved 435 times

**Yuchen**

CONTACT ME

More about the host

93%  
RESPONSE RATE

within a day  
RESPONSE TIME

5 days ago  
CALENDAR UPDATED

How does Airbnb promote safety?

- Educate yourself about safety
- Protected by the \$1,000,000 Airbnb Host Guarantee
- 24/7 phone support
- Rich user profiles and reviews

A searcher who clicks on a listing in the search results sees the following view. The ratings and text of reviews for the listing are visible lower on the page.



Figure 3: Listing Calendar

Sun	Mon	Tue	Wed	Thu	Fri	Sat
27 \$250	28 \$200	29 \$250	30	31	1	2
3 \$300	4	5	6	7	8	9
10	11 \$250	12 \$200	13 \$200	14 \$250	15	16
17	18 \$250	19 \$200	20 \$200	21 \$200	22	23
24	25	26 \$250	27	28	29	30 \$250

Available
Unavailable
Past

Above is the calendar tab of the listings page. Dates that have already been booked or that the host has marked unavailable are in red.

Figure 4: Inquiry Submission Form

Check in	Check out	Guests
<input type="text" value="09/13/2013"/>	<input type="text" value="09/16/2013"/>	<input type="text" value="2"/>

Tell Alleyn what you like about their place, what matters most about your accommodation, or ask them a question.

Hi,  
  
I'm an Airbnb employee that wants to check out Portland for a weekend with two friends. Is your place available?

☒ **Reuse this message next time I contact a host**  
Contacting several places considerably improves your odds of a booking.

**Can this host call you about your inquiry?** ☒ Yes ☐ No

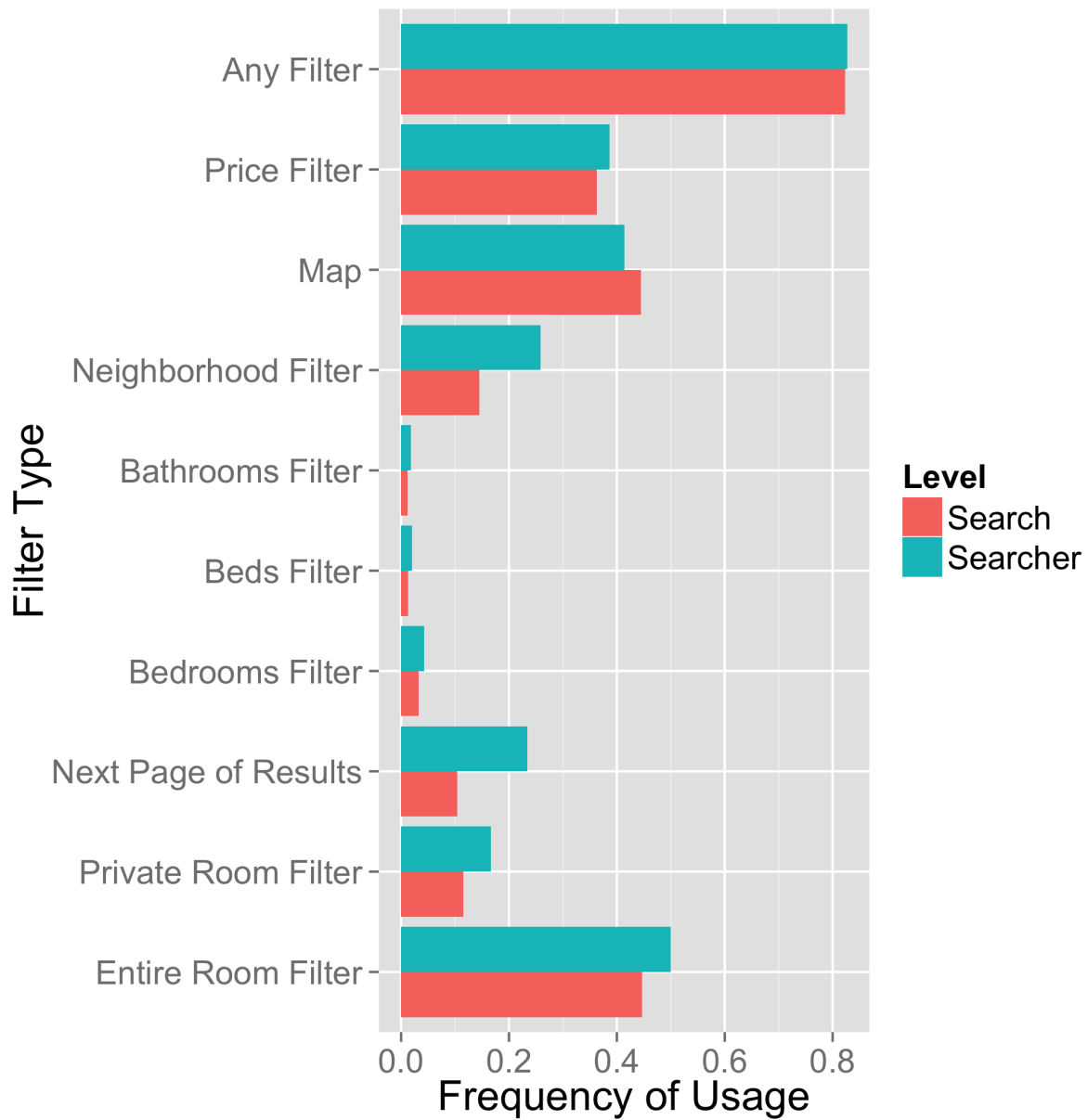
Your number won't be revealed. They can only call from 9am to 9pm in your time zone.

Your time zone:

SEND MESSAGE

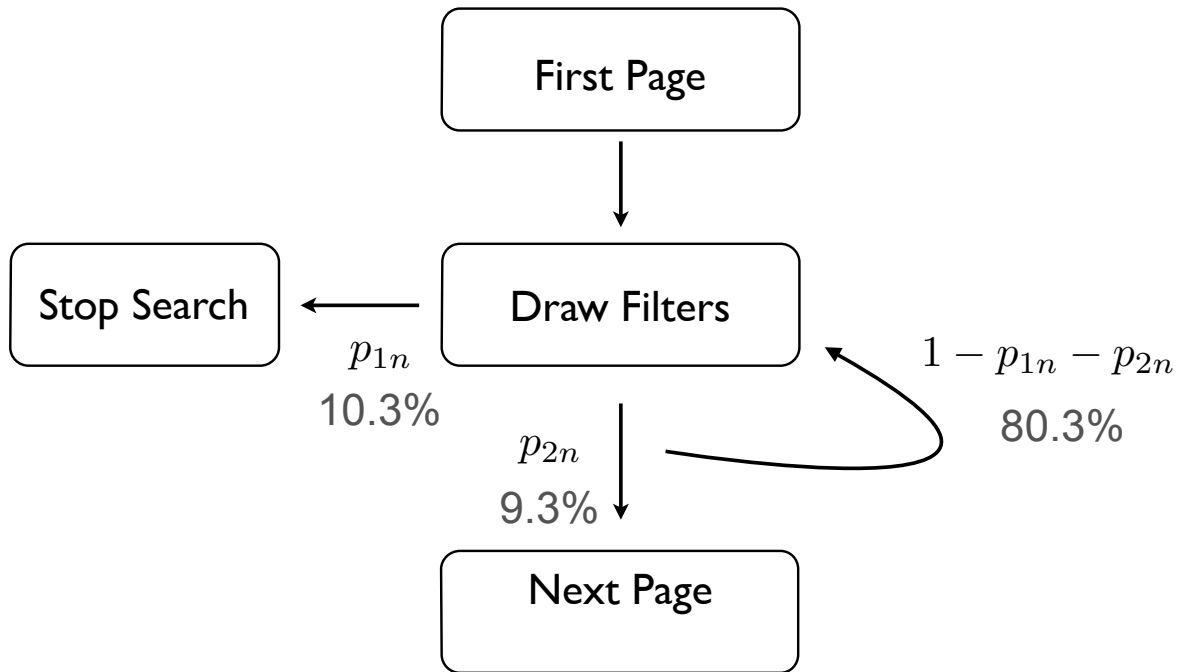
Above is the prompt that searchers see when they click the “Contact Me” button.

Figure 5: Frequency of Filter Usage



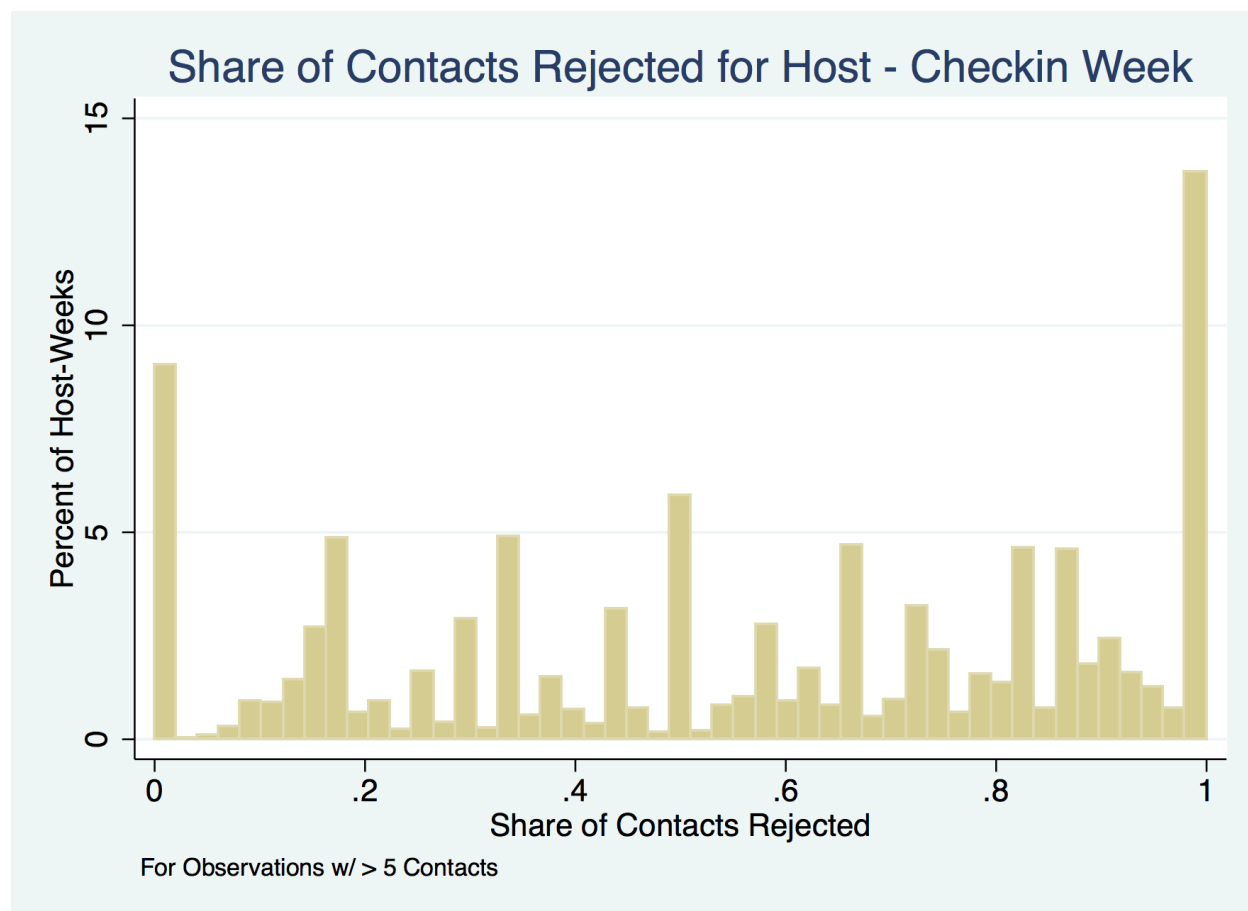
The above plot displays the share of searches and searchers that use each respective filter.

Figure 6: Consideration Set Formation Model



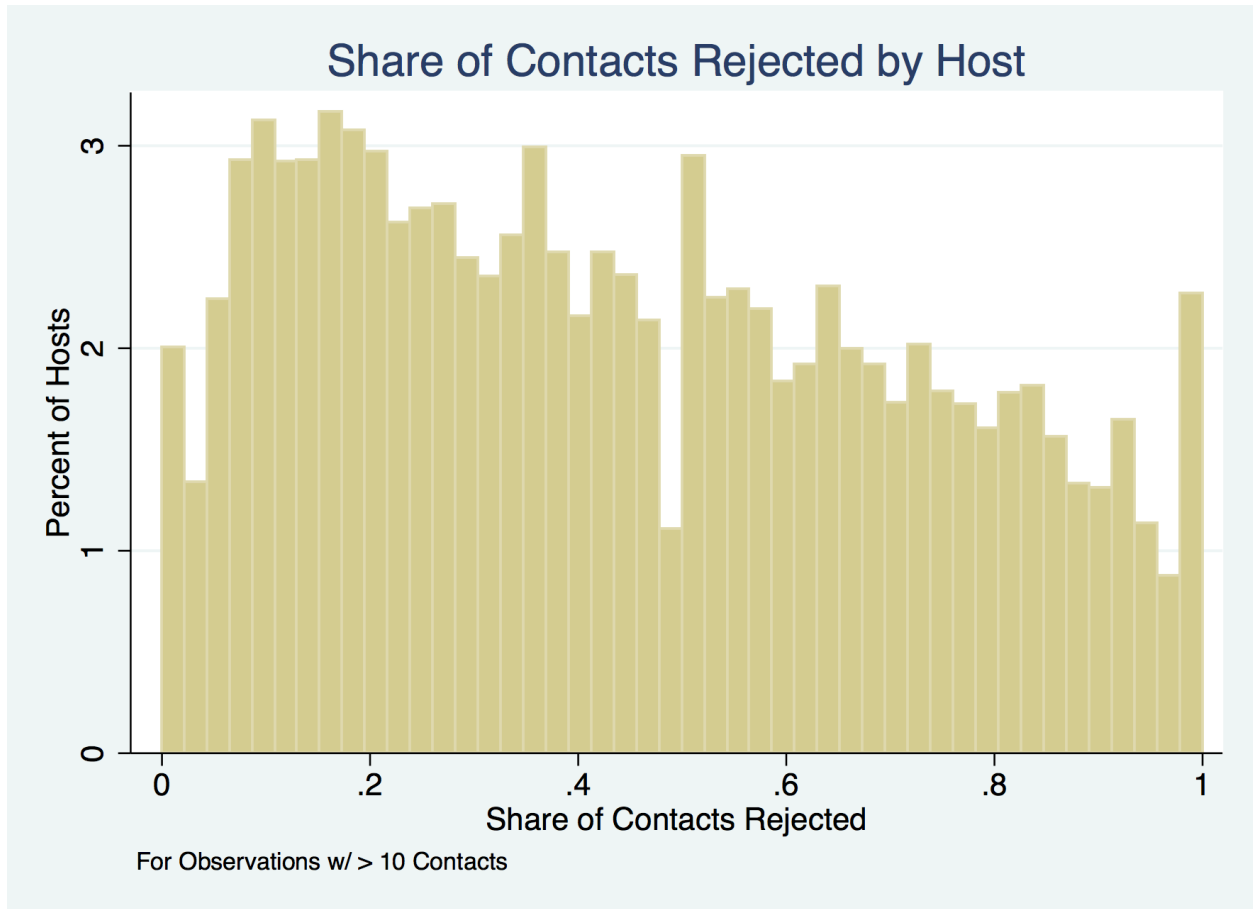
The above plot displays the possible transition paths for a seacher using the search engine. “n” denotes the sequential order of the page view and the displayed probabilities are averages across the sample.

Figure 7: Average Rejection Rates by Host-Week



Each observation in the above histogram is a listing and a week of check-in in major US markets in 2012. Only observations with more than 5 inquiries for that week are included.

Figure 8: Average Rejection Rates by Host



Each observation in the above histogram is a listing in a major US market in 2012 with at least 10 inquiries.

## 8 Tables

Table 1: Model of the Next Search Action

	Stop Search	Next Page of Results
Constant	-2.161	-2.747
Page View Number	-0.024	-0.017

Number of Observations: 207816

The above table displays the coefficients of a multinomial logistic regression which predicts whether the next action of a searcher is to do a new search, to stop search or to click to the next page of results. The “Page View Number” is the chronological order of the page view within the set of searches that a given searcher conducted. The normalized category in the regression is to do a new search.

Table 2: Filtering Behavior During Search

	<i>Dependent variable:</i>		
	Used Neighborhood Filter or Map	Used Room Type Filter	Used Price Filter
	(1)	(2)	(3)
Page View Number	0.017*** (0.0002)	0.013*** (0.0001)	0.007*** (0.0001)
Constant	-0.095*** (0.004)	-0.844*** (0.004)	-0.101*** (0.004)
Observations	424,884	424,884	424,884

\*p<0.1; \*\*p<0.05; \*\*\*p<0.01

The above table displays the coefficients of a logistic regression which predicts whether a given search uses a specific filter. The “Page View Number” is the chronological order of the page view within the set of searches that a given searcher conducted.



Table 3: Does Rejection Lead to Fewer Bookings?

	(1)	(2)
Rejected	-0.503*** (0.00127)	-0.505*** (0.00128)
Week FE	No	Yes
Market FE	No	Yes
Trip Characteristics	No	Yes
Observations	547680	547680

The above table displays the results of a linear probability model that predicts whether an individual will eventually book given that their initial inquiry was rejected. Specification 2 includes week, market and trip fixed effects.

Table 4: Demand Estimates (In Dollar Terms)

	Baseline	With Listing RE
Prof. Pic.	0.807 (0.662)	0.839 (0.855)
Capacity	-2.455*** (0.311)	-2.343*** (0.338)
1 Room	7.393*** (1.671)	5.971*** (1.818)
Num Reviews	0.052*** (0.018)	0.065** (0.026)
No Review	52.987*** (7.750)	47.775*** (8.808)
Avg. Rating	10.787*** (1.612)	10.005*** (1.834)
Location Quality	-1.731 (3.652)	1.010 (4.665)
Location Quality Sq.	0.426 (0.748)	-0.105 (0.964)
No Location Quality	-7.903*** (1.285)	-7.528*** (1.210)
Prop. Mgr.	-7.069*** (0.938)	-8.970*** (1.229)
Entire Prop.	7.961*** (0.982)	7.699*** (1.141)
Neighborhood in Filter	6.156*** (0.725)	6.268*** (0.685)
Room Type In Filter	13.282*** (0.863)	12.381*** (0.810)
Unusual Prop. Type	-20.527*** (3.849)	-12.274*** (4.697)
Prop. Price * No Price Filter	-0.306*** (0.022)	-0.279*** (0.021)
Price * Filter Price [10,100)	-1.000*** (0.060)	-1.000*** (0.060)
Prop. Price * Filter Price In [100,200)	-0.514*** (0.023)	-0.486*** (0.024)
Prop. Price * Filter Price In [200,300)	-0.348*** (0.023)	-0.317*** (0.023)
Prop. Price * Filter Price > 300	-0.293*** (0.024)	-0.269*** (0.024)
1 Room * Num. Guests	-5.690*** (0.666)	-4.872*** (0.658)
Capacity * Num. Guests	0.293*** (0.096)	0.319*** (0.094)
Price * Age NA	0.076*** (0.018)	0.074*** (0.017)
Price * Age	0.002*** (0.0004)	0.001*** (0.0004)
Price * Guest Rev.	-0.022* (0.011)	-0.020* (0.011)
Price * Nights	0.015*** (0.002)	0.013*** (0.002)
Price * Guests	0.029*** (0.003)	0.029*** (0.003)
Avg. Hotel Price * No Price Filter	-0.193*** (0.036)	-0.177*** (0.034)
Avg. Hotel Price * Filter Price In [10,100)	-0.615*** (0.047)	-0.617*** (0.046)
Avg. Hotel Price * Filter Price In [100,200)	-0.387*** (0.037)	-0.369*** (0.036)
Avg. Hotel Price * Filter Price In [200,300)	-0.235*** (0.039)	-0.215*** (0.037)
Avg. Hotel Price * Filter Price > 300	-0.176*** (0.040)	-0.164*** (0.038)
SD. Error	18.17	17.02
SD. Listing Random Effect		8.28
Num. Search Attempts	8,987	8,987
Num. Guest-Host Obs.	569,864	569,864

The above table displays the coefficients associated with the outside option in the demand model for searchers. The coefficients are normalized by the price coefficient for searchers who set a price filter between 10 and 100 dollars. The demand model is estimated on a sample of all searchers who used at least one neighborhood filters in City X from April to July of 2013. Neighborhood fixed effects are included in both specifications. “Prop. Price” refers to the listing price inclusive of fees. “Prop. Mgr.” is an indicator that takes on the value 1 if a host manages more than 4 listings. “Prof. Pic.” is an indicator for whether the picture was taken by a verified Airbnb photographer. “Entire Property” is an indicator variable that takes the value 1 when the entire property is being rented out. “Neighborhood in Filter” is an indicator variable for whether the neighborhood a listing is in was filtered for. “Location Quality” refers to a locally smoothed value of the location review ratings for listings close to the viewed listing. “Capacity” refers to the number of guests a host can accommodate. “Guest Has Rev” is an indicator variable for whether the searcher has been reviewed. Standard errors are in parentheses.

Table 5: Demand Estimates (In Dollar Terms):  
Outside Option Variables

	Baseline	With Listing RE
Outside Option	148.561*** (16.644)	140.662*** (19.236)
Out. Opt. * Num. Pages	-0.332*** (0.027)	-0.310*** (0.025)
Out. Opt. * Nights	3.191*** (0.352)	2.623*** (0.343)
Out. Opt. * Guests	-1.085 (0.984)	-0.240 (0.977)
Out. Opt. * Age	0.097 (0.074)	0.097 (0.070)
Out. Opt. * Age NA	2.537 (3.075)	2.690 (2.909)
Out. Opt. * Guest Has Rev	4.263** (1.765)	4.067** (1.672)
Out. Opt. * Days In Advance	0.203*** (0.019)	0.211*** (0.018)
SD. Error	18.17	17.02
Num. Search Attempts	8,987	8,987
Num. Guest-Host Obs.	569,864	569,864

The above table displays the coefficients associated with the outside option in the demand model for searchers. The coefficients are normalized by the price coefficient for searchers who set a price filter between 10 and 100 dollars. The demand model is estimated on a sample of all searchers who used at least one neighborhood filters in City X from April to July of 2013. Neighborhood fixed effects are included in both specifications. “Avg. Hotel Price” refers to the average hotel price, “Days Ahead” refers to the number of days before the check-in at which the inquiry was sent. “Num Filters Used” refers to the number of neighborhoods ever selected for filtering by the searcher. “Viewed Listings” refers to the number of distinct listing viewed by the searcher. “Guest Has Rev” is an indicator variable for whether the searcher has been reviewed. Standard errors are in parentheses.

Table 6: The Determinants of Host Screening

(a) Guest Characteristics

	Baseline	Listing Random Effects
Guest Not American	-0.122*** (0.040)	-0.161*** (0.045)
Guest Has Review	-0.265*** (0.098)	-0.325*** (0.110)
Guest Has Prev. Stay	-0.036 (0.054)	-0.052 (0.061)
Guest Has Description	-0.103** (0.050)	-0.066 (0.057)
Guest Has Picture	-0.013 (0.047)	0.038 (0.054)
Guest Has Rec.	0.062 (0.105)	0.044 (0.118)
Guest Filled Female	-0.086 (0.055)	-0.107* (0.061)
Guest Filled Male	0.063 (0.057)	0.031 (0.064)
Days In Advance	-0.004*** (0.001)	-0.005*** (0.001)
Nights	-0.205*** (0.024)	-0.294*** (0.027)
Nights Sq.	0.014*** (0.002)	0.020*** (0.002)
Guest Age	0.022 (0.085)	0.074 (0.096)
Guest No Age	-0.002 (0.002)	-0.001 (0.002)
<i>N</i>	17,831	17,831
Log Likelihood	-9,911.224	-8,823.851
SD. Host RE		1.298
Trip Characteristics	YES	YES
Month FE	YES	YES

NA

The above table displays the coefficients on host characteristics in a logistic regression that predicts rejections by hosts. Column 1 displays results from a model without listing specific random effects and column 2 includes random effects. “Guest Rev.” is an indicator variable for whether the guest has been reviewed.

	Baseline	Listing Random Effects
Listing Capacity	−0.034*** (0.009)	−0.036 (0.026)
Host Selective Instant Book	−0.434*** (0.075)	−0.221 (0.161)
Host All Instant Book	−0.980*** (0.098)	−0.802*** (0.191)
Social Network Instant Book	0.818*** (0.169)	0.793** (0.334)
No Prior Inquiries	−1.381*** (0.424)	−1.286** (0.577)
No Prior Responses	−1.719*** (0.436)	−0.127 (0.603)
Response Time	0.011*** (0.002)	−0.001 (0.004)
Response Rate	−3.036*** (0.137)	−1.271*** (0.241)
Avg. Review Score	−0.084*** (0.027)	−0.017 (0.042)
Price Listed	0.001*** (0.0003)	0.001 (0.001)
No Reviews	−0.331** (0.136)	0.035 (0.216)
Log(Num. Room Rev. + 1)	−0.071*** (0.020)	−0.055 (0.052)
Property Manager	−0.153* (0.082)	−0.200 (0.159)
Entire Property	0.433*** (0.080)	0.576*** (0.153)
Host No Age	−0.693*** (0.104)	−0.711** (0.278)
Host Age	−0.023*** (0.003)	−0.024*** (0.007)
Host Filled Female	−0.181*** (0.067)	−0.203 (0.202)
Host Filled Male	−0.202*** (0.067)	−0.282 (0.203)
<i>N</i>	17,831	17,831
SD. Host RE		1.298
Trip Characteristics	YES	YES
Month FE	YES	YES

NA

The above table displays the coefficients on host characteristics in a logistic regression that predicts rejections by hosts. Column 1 displays results from a model without listing specific random effects and column 2 includes random effects. “Rev.” refers to the number of reviews that the listing had at the time of the inquiry. “Prop. Mgr.” is an indicator that takes on the value 1 if a host manages more than 4 listings. “Age” refers to the host’s age. “Full Property” is an indicator variable that takes the value 1 when the entire property is being rented out.

(b) Host Characteristics

	Baseline	Random Effects
Prop. Mgr. * Rev. Guest	0.234* (0.140)	0.397** (0.159)
Entire Prop. * Rev. Guest	0.224** (0.101)	0.259** (0.114)
Prop. Mgr. * Days In Adv.	0.002** (0.001)	0.003** (0.001)
Entire Prop. * Num. Guests	-0.118*** (0.033)	-0.100** (0.043)
<i>N</i>	17,831	17,831
Log Likelihood	-9,911.224	-8,823.851
SD. Host RE		1.298
Trip Characteristics	YES	YES
Month FE	YES	YES

The above table displays the coefficients on host characteristics in a logistic regression that predicts rejections by hosts. Column 1 displays results from a model without listing specific random effects and column 2 includes random effects. “Prop. Mgr.” is an indicator that takes on the value 1 if a host manages more than 4 listings. “Full Property” is an indicator variable that takes the value 1 when the entire property is being rented out. “Days Ahead” refers to the number of days before the check-in date at which the searcher entered the market.

(c) Host - Guest Characteristics

Table 5: RE Search Outcomes

	Num. Simultaneous Contacts - 1	Num Sequential Contacts
2 Initial Con.		0.226*** (0.027)
3 Initial Con.		0.336*** (0.040)
4 Initial Con.		0.566*** (0.057)
5 + Initial Con.		0.933*** (0.042)
Rev. Guest	-0.595*** (0.074)	0.621*** (0.086)
Exp. Guest	-0.464*** (0.067)	-0.079 (0.087)
3 - 6 Days Ahead	-0.047 (0.058)	0.279*** (0.062)
7 - 13 Days Ahead	-0.239*** (0.057)	0.551*** (0.058)
14 - 20 Days Ahead	-0.132** (0.059)	0.417*** (0.060)
21 - 27 Days Ahead	-0.210*** (0.064)	0.497*** (0.063)
28 - 55 Days Ahead	-0.225*** (0.054)	0.655*** (0.056)
56 + Days Ahead	-0.231*** (0.057)	0.722*** (0.057)
Gender Filled Female	0.144*** (0.041)	0.184*** (0.032)
Gender Filled Male	0.053 (0.043)	0.213*** (0.033)
<i>N</i>	15,190	10,354

Column 1 displays the results of a Poisson regression of number of inquiries after initial rejections on trip and guest characteristics. Column 2 displays the results of a regression of number of simultaneous inquiries on guest and trip characteristics. “Initial Con.” refers to the number of inquiries a searcher sent simultaneously at the start of search. “Rev.” and “Exp.” referred to whether the guest was reviewed or had a prior trip, respectively. “Days Ahead” refers to the number of days before the check-in date at which the searcher entered the market. “Filled Female” and “Filled Male” refer to cases when there was information on the gender of the searcher. The estimation sample consists of all non-foreign language inquiries sent by guests in City X between January 2012 and July 2013.



Table 6: Simulation Parameters

Calibrated Parameter	Value
Mean Hours To Book	20.24
Probability of Leaving After Non-Rejection	0.17
Sequential Search Multiplier	2
Simultaneous Search Multiplier	1.4

The mean hours to book and the probability of leaving after a non-rejection were calibrated to match the mean of those moments in the data. The sequential and simultaneous search multipliers were set so that the baseline simulation matches the intensity of sequential and simultaneous search in the data. Simultaneous search refers to the inquiries initially sent by a searcher. Sequential search refers to the inquiries that occur after an individual has been rejected from all the initial inquiries.

Table 7: Simulation Results

	Counterfactual	Share Contact	Share Book	Share Rejected	Avg. Revenue	Avg. Consumer Surplus
1	Data	0.621	0.374	0.473	112.754	
2	Baseline	0.628	0.353	0.438	137.507	31.516
3	Hide Screeners	0.603	0.448	0.181	171.189	42.359
4	Hide Congestion	0.625	0.362	0.420	140.105	32.720
5	Hide Unavailable	0.613	0.381	0.359	149.146	34.971
6	Full Choice Set	0.914	0.556	0.420	199.500	36.339
7	Hide Rejections	0.587	0.487	0	183.843	46.414
8	Hide and Full Set	0.830	0.689	0	246.352	49.502
9	Avg. Quality Algorithm	0.708	0.362	0.517	118.166	34.270
10	Personalized Quality Algorithm	0.726	0.387	0.494	144.171	38.827
11	Transaction Probability Algorithm	0.729	0.390	0.487	144.923	40.114

Row 1 displays the outcomes that actually occurred for City X and the week of April 10, 2013. The remaining rows display outcomes under counterfactual scenarios. Share contacted is the share of searchers that sent at least one inquiry. Share booked is the share of searchers that booked a room. Share rejected refers to the share of all inquiries that are rejected by the host.

Table 8: A/B Test Results (Percentage Differences)

	Ranking Algorithm:							
	Avg. Quality				Personalized Quality			
	A/B Treatment Effect	Full Rollout Effect	Half Rollout Effect	A/B Treatment Effect	Full Rollout Effect	Half Rollout Effect	Full Rollout Effect	Half Rollout Effect
Share Booking	5.5	2.5	6.3	11.1	9.6	9.9		
Share Contact	17.9	12.8	6.5	19.4	15.7	8.6		
Initial Contacts Per Contacter	2.2	2.2	1.7	3.6	3.0	1.9		
Share Rejected	24.3	17.9	2.8	21.2	12.7	1.9		
Avg. Revenue	-14.1	-14.1	-3.0	5.2	4.8	5.6		
Avg. Consumer Surplus	11.3	8.7	10.8	27.8	23.2	20.4		

The above table displays three types of treatment effects for two of the proposed ranking algorithms: a non-personalized ranking algorithm and a personalized ranking algorithm. Column 1 shows the treatment effect (%) of seeing the non-personalized ranking algorithm in a 50% experiment at a searcher level. Column 2 shows the difference in outcomes across two identical markets where all searchers in one market saw the non-personalized ranking algorithm and all searchers in the other market saw the old ranking algorithm. Column 3 shows the difference in outcomes across two identical markets where half of all searchers in one market saw the non-personalized algorithm and all searchers in the other market saw the old ranking algorithm.

Table 9: Matching Function Estimates

	log(Bookings)
Personalized Rank	0.074 (0.115)
log(Listings)	0.171*** (0.016)
log(Searchers)	0.805*** (0.011)
Personalized Rank * log(Listings)	0.032 (0.023)
Personalized Rank * log(Searchers)	-0.031* (0.016)
Constant	-0.924*** (0.081)
Observations	270

*Note:* \*p<0.1; \*\*p<0.05; \*\*\*p<0.01

The above table displays estimates of a matching function from the simulated market outcomes where the number of guests and hosts were exogenously varied. “Personalized Rank” refers the algorithm that personalizes the results to the searcher.

## A Appendix: Rejection Classification

This Appendix describes how to use a regularized logistic regression to classify the text of communications between hosts and guests. I divide each message into individual words and combinations of words (n-grams).<sup>41</sup> I use n-grams as features in a regularized logistic regression (RLR) that predicts whether a message is a rejection or not.

The process of classification requires two steps: training and prediction. The procedure requires definitive cases when a message is either a rejection or not a rejection. A definitive case of a non-rejection occurs when a thread eventually leads to a transaction. A definitive case of a rejection occurs in a subset of messages for which hosts label that the room is “Not Available”. I choose the top 30 thousand n-grams in my sample in addition to features for question marks and the number of sentences for my classifier. Prior to classification, I correct the text for common misspellings and determine the language of the text (See Appendix for details).

The RLR is estimated using 500 thousand labeled messages. The purpose of using regularization is to reduce over-fitting that might occur when so many features are included. The RLR penalizes the model for having too many non-zero coefficients. The classifier places high weight on n-grams such as “Sorry”, “Unfortunately”, “Is Occupied” for rejections. I test the validity of the procedure using two methods. First, I use the estimated model to classify a hold-out sample of labeled data. The classifier achieves a type 1 error of 2.6% and a type 2 error of 2.0%. That is, 2.6% of non-rejections are labeled as rejections and 2.0% of rejections are mistakenly labeled as non-rejections. The second validation I use is a manual inspection of 500 previously unlabeled messages. The classifier has a type 1 error of 3.4% and a type 2 error 8.1% in that subsample.

I combine classifications from the NLP classifier with cases when the response is discernibly through other methods. The final classification works as follows. If a contact led to a booking or if it was labeled as accepted by the host then it is classified as ‘not rejected’. If a response was labeled by the host as a rejection or if there was no response within the week after the inquiry then the contact is classified as a rejection. If a response is classified as having a foreign language then it is not used in the analysis.<sup>42</sup> Lastly, if the contact does not fit into any of the above categories, the NLP classifier is applied to the first (or in some cases second) response by a host to a guest. In total, 49% of all inquiries were rejected. Of all contacts classified as rejections, 37% were cases in which a host did not respond, 30% were host classified rejections after an inquiry and 32% used the NLP classifier.

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<sup>41</sup>For example, “car” is a 1-gram, “my car” is a 2-gram and “my fast car” is a 3-gram.

<sup>42</sup>An inquiry with 3 or more words was tested for being in a foreign language if it had more than 30% of words that were not in the English dictionary and were not common misspellings. The message text was

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run through a language detection algorithm in Python called “guess-language” (<http://code.google.com/p/guess-language/>). If the algorithm guessed a valid non-English language then the inquiry was classified as being in a foreign language. A 50% cutoff was used for inquiries with 2 words.

## B Appendix: Derivation of Sample Weights

Table B.1: Determinants of Ranking

	Baseline
Listing Age	−0.002*** (0.0001)
No Rating	−17.563 (364.607)
Days Since Update	−0.003*** (0.001)
Price	0.0001 (0.0001)
Avg. Rating	−0.341*** (0.048)
Num. Reviews	0.057*** (0.001)
No Reviews	11.590 (364.607)
Entire Prop.	1.055*** (0.055)
Num. Pictures	0.034*** (0.002)
Neighborhood FE	YES
Num. Search Attempts	7,889
Num. Search-Listing Obs.	387,515

The above table displays the coefficients on listing characteristics which predict whether that listing is shown on the first page of search results. The model estimated is a conditional logistic regression.

## C Appendix: An Urn and Balls Model of Matching

To see how search frictions affect the matching rate consider the simple urn and ball model of matching described in [23]. Suppose there exists a mass,  $G$ , of identical guests sending 1 inquiry each to a mass,  $L$ , of identical listings that can only transact with one guest each. The resulting number of matches produced is  $L(1 - e^{-G/L})$ . If an all-knowing social planner was matching guests and listings then the total amount of matches would be  $\min(G, L)$ .



To simplify further analysis, suppose that  $L < G$ . Therefore, the total inefficiency in the marketplace is a function of the failed matches,  $Le^{-G/L}$ . Inefficiency in this model comes from a coordination friction, where some listings reject guests because they are already booked. The welfare costs of the friction in this model are a function of the match utility of unmatched agents who could have been matched and the costs of wasted search.

Another friction that exists on Airbnb is that some listings are not actually available to anyone. Suppose that there is a mass of stale listings,  $U$ , which are not interested in transacting although they are visible to guests. The amount of matches in the marketplace becomes  $L(1 - e^{-\frac{G}{L+U}})$ , with the amount of inefficient search equal to:  $Le^{-\frac{G}{L+U}} > Le^{-G/L}$ . Stale listings increase inefficiency due to additional mismatch and wasted search costs. Stale listings could be even more important in dynamic matching markets because the likelihood of a stale listing being contacted increases as non-stale listings are booked.

Lastly, there are some hosts who are selective about which guests and trips they are willing to host. Suppose that listings are only willing to transact with a random subset of searchers. Let there be a mass of  $K$  selective sellers who are willing to transact with a random guest at a rate  $c$ . The remaining  $L - K$  non-selective sellers are willing to transact with anyone. The aggregate number of matches in the marketplace will be  $(L - K)(1 - e^{-\frac{G}{L+U}}) + K(1 - e^{-\frac{cG}{L+U}})$  and the number of inefficient inquiries is,  $Le^{-\frac{G}{L}} + K(e^{-\frac{cG}{L}} - e^{-\frac{G}{L}})$ , where the first term represents coordination and stale vacancies and the second term represents screening frictions. In turn, the cost of screening frictions depends on the share of listings which are selective,  $\frac{K}{L}$  and on the selectivity of the listings,  $c$ .

The frictions in an urn and balls model all operate through the rejection channel. When inquiries are rejected, search effort is wasted and potential transactions do not happen. A full model, such as the one of the paper, would account for the ability of searchers to conduct sequential and simultaneous search. Furthermore, such a model would allow for some searchers to leave after being being accepted for a variety of reasons. Nonetheless, most of the intuition from an Urn and Balls model will hold in more realistic models of matching. Rejections will occur, will be costly to searchers and will slow the rate of match formation. The quantitative impact of frictions must, however, be determined within a more realistic model that accounts for heterogeneity, simultaneous search and dynamics.