Is Uber's Surge-Pricing an Example of High-Tech Gouging?

By Annie Lowrey

January 10, 2014
https://www.nytimes.com/2014/01/12/magazine/is-ubers-surge-pricing-an-example-of-high-tech-gouging.html

At 10 p.m. on New Year's Eve, I hailed a taxi outside my apartment in Adams Morgan and directed it to a friend's apartment in Shaw, a nearby neighborhood, also in Northwest Washington. It took a mere minute to find an open car, and the traffic-clogged two-mile trip cost $13, including tip.

Three hours later, early in the morning on New Year's Day, I figured that hailing a cab would be difficult if not impossible, and I requested a black car from the app-based service Uber. It took three minutes for a sleek sedan to arrive, and Uber let me know that I would be charged two and a half times its normal fare — part of its "surge pricing" strategy, implemented to help keep supply in line with demand, the company says. That ride home cost $47, no tip necessary.

The same service. The same amount of time. The same trip, if in reverse. And a price differential of three and a half times. That kind of arithmetic has, of late, enraged many of Uber's users, who accuse the company of ripping off consumers when they need a ride the most: during holidays, deluges and snowstorms. The reaction from Uber has been equally strong. In short: Don't want to pay the fare? Fantastic. Don't use the service.

From the perspective of the San Francisco-based start-up, the dispute is born of a mistaken identity more than anything else. Uber seems to be a fancy taxi company. It works much the way a taxi dispatcher does. It competes directly with taxi services in cities like Boston, Washington and New York — and it is rapidly expanding to cities including Doha, Hyderabad and Shenzhen. But Uber considers itself a market maker rather than a service provider. It's a network that connects drivers to fares, more like a travel agent than an airline.

For the uninitiated, Uber gets you from Point A to Point B for a fixed, transparent rate, much the way a cab does. You hail an Uber car on your smartphone rather than flagging it down on the street or pleading with a livery-cab operator who offers a gnomic "15 minutes!" before slamming the phone down. The car tends to be a spotlessly clean Lincoln Town Car rather than a seemingly suspensionless Crown Vic. And you pay automatically through the smartphone app, rather than swiping a credit card in the car or handing over cash.

Uber is upscale, and typically costs about 50 percent more than the local competition. More important, lately anyway, its rates fluctuate with demand. When a lot of people are looking for an Uber car — like during a recent New York snowstorm, or Washington on New Year's Eve — it sets the rate higher, in the hope of increasing supply, by enticing more of its drivers to come out or stay out. (Regardless of intent, the prices jump quickly, and from a user's point of view, work more as a form of demand-limiting price discrimination than supply-inducing incentive.)

During a recent New York snowstorm, some rides cost 8.25 times the standard price. The response from the tiny violin chorus was fervent. Salman Rushdie took to Twitter to kvetch about surge pricing. Tim O'Reilly, the digital-media guru, accused the service of price gouging. Even Jessica Seinfeld, recipient of so much syndication bounty, Instagrammed a receipt for a $415 Uber ride with the hashtags #neverforget, #neveragain and #real. And in one spectacular, if anonymous, freakout, an enraged user wrote to the company saying that he used to find the service "amazing," until he spent $360 on two rides on a Saturday. The kicker: "I WILL NEVER USE YOUR COMPANY AGAIN! I AM OUTRAGED AND DISGUSTED THAT YOU WOULD JACK UP YOUR CHARGES THAT MUCH BECAUSE OF A SNOW STORM!!!"

That complaint got a formal response from Uber's chief executive, Travis Kalanick. "Get some popcorn," he advised readers on his Facebook page before publishing his own long retort. "We do not own cars nor do we employ drivers," he wrote. "Higher prices are required in order to get cars on the road and keep them on the road during the busiest times. This maximizes the number of trips and minimizes the number of people stranded. The drivers have other options as well. In short, without Surge Pricing, there would be no car available at all."

In Kalanick's mind, the variable pricing benefits passengers: They pay more, but they are buying certainty and shorter wait times, and wait times spent in the comfort of their homes, or bars or offices, rather than on the street. But paying a flat rate for a taxi is so deeply, deeply ingrained that it feels as if Uber is breaking the rules by suddenly charging more. After all, for as long as taxis have been around, governments have required them to charge standardized fares both as a consumer protection and as a way of regulating the market. (London issued rules about the number of horse-drawn carriages on its streets and the fares they were able to charge back in the 1600s, during the reign of Charles I.)

Over email, Kalanick said that Uber's proprietary surge-pricing algorithm tries to maximize the number of rides, not revenue. It would prefer to match 1,000 fares at the baseline price than 100 fares at 11 times that rate; in other words, even if that might mean less money for Uber. (The company takes 20 percent of all fares.) "If we can do more trips at a lower surge multiple, then the algorithms will automatically lower the multiple," Kalanick said. "Surge pricing is critical to get suppliers on the road and on our system. Without it, we would do significantly fewer trips."

But on a night like New Year's Eve, does a multiple of seven really draw out more drivers than a multiple of five? According to Kalanick, yes. But there is no way for customers to gauge supply and demand for themselves beyond looking at the dynamic-pricing multiple. And dynamic pricing is still not the same thing as true market pricing — like an auction system in which riders and drivers bid for one another's services. Its opacity goes a long way to explaining the frustration it has generated.

For Uber, one risk seems to be that its surge pricing might work in the short term but alienate customers in the long term. Say you decide to blow $100 on a short ride one rainy night, when the algorithm fails to entice enough drivers onto the road and the prices surge. Like Jessica Seinfeld, you decide "never again." Is the algorithm really ensuring the maximum number of rides in that scenario? (A leaked spreadsheet of Uber's financials seems to indicate strong demand, regardless.)

And with a normal cab, of course, sometimes a rider really lucks out. Another Washingtonian eager to get to her New Year's Eve party probably would have happily thrown a driver a fiver to pick her up instead of me. In effect, I and every other person in central D.C. who managed to catch a cab on New Year's Eve actually got a ride on the cheap.

Market efficiency is not always the same thing as consumer benefit — a lesson worth learning in the digital age, for Uber riders as well as everyone else. There are far more sly forms of technology-enabled price discrimination out there, from airlines charging more if you are using a savvy web browser to online retailers charging you more if you are from a posh ZIP code. But on the Internet, the deck is still stacked on the consumer's side, given the web's powerful ability to facilitate comparison shopping. Shocked by Uber's surge prices, after all, there's nothing from holding an Uber user back from hoofing it home free or trying her luck waving her arms at the passing, fixed-price cabs on the street.