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What Strategies Should Uber Take to Gain Profitability and Keep Sustainability of Business

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I Background

In 2009, Uber, originally called UberCabs, was founded by Garrett Camp and Travis Kalanick. Camp wanted to reduce the cost of transportation and found out that sharing the car with other people could be a good idea. At first, Uber only provided private luxury car service for Silicon Valley's top executives. Later, Kalanick realized that Uber could explore greater profit in empty limousine seats and idling taxis.

In 2011, Uber's services and mobile app officially launched in San Francisco. Users can only get a black luxury car and the price was 1.5 times that of a taxi at that time. In 2012, UberX was introduced, a cheaper option that offers non-luxury vehicles. They should pass the background check, meet the registration requirement and car standards. In 2013, drivers can use their own cars as part of UberX, which led to much lower prices. UberBLACK and taxi drivers argued that inadequate driver screening and training endangered consumers and made for unfair competition in the highly regulated industry. In 2014, UberPOOL, a carpooling service, and UberEats, a food delivery service, are launched.

The company expanded rapidly, and by March 2016, it was operating in 400 cities in 65 countries, with more than 162,000 active driver partners. However, it sold its operations in China to DiDi after facing tough competition in China.

Aside from China, Uber had encountered significant political headwinds in a number of markets; fierce resistance came from Portland, Oregon; Paris, France; Miami, Florida; Denver, Colorado; and Washington, DC. Some states such as California fined the company for regulatory violations. Uber has had legal clashes in Germany, and in Spain, Colombia, France, Australia, Italy, Denmark, and England.

II The Business of Ride-Hailing

1. Trip fare composition

- Standard Trip Fare: Base fare + miles + minutes (depending on city & car type)
- Surge: Multiplier to the standard rates when demand increases (e.g. 1.8x, 2.5x, up to 8.0x) [1]
- Other fees: Long pick up, waiting, …

Exhibit: Uber Fare Rates in NYC[2]

Type	Base Fare	$/Minute + $/Mile	Minimum Fare
UberX	$2.55	$0.35 per minute + $1.75 per mile	$7.00
Uber XL	$3.85	$0.50 per minute + $2.85 per mile	$10.50
Uber BLACK	$7.00	$0.65 per minute + $3.75 per mile	$15.00
Uber SUV	$14.00	$0.80 per minute + $4.50 per mile	$25.00
Uber T	$2.50	$0.50 per 1/5 mile or $0.50 per minute	$2.50

Exhibit: Lyft NYC Rates[3]

Type	Base Fare	$/Minute + $/Mile	Minimum Fare
Lyft	$0	$0.67 per minute + $1.48 per mile	$7.30
Lyft XL	$0	$0.69 per minute + $2.11 per mile	$9.43
Lux Black	$6.95	$0.84 per minute + $2.74 per mile	$13.47
Lux Black XL	$13.24	$1.19 per minute + $4.04 per mile	$22.43

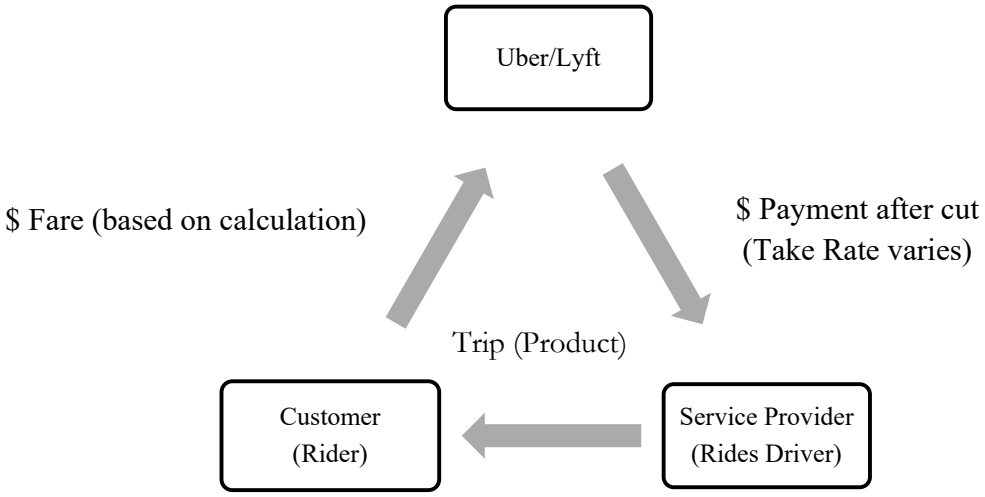
2. Outside option – Taxi

- Taxi in NYC ($2.5, $0.50/every minute or 0.2 mile, no surge prices but $0.50 surcharge from 8pm to 6am and $1 during rush hour, which is 4pm to 8pm on weekdays)

3. Ride-hailing – Platform Business Model

- Product: the ride
- Supplier: Platform-authenticated drivers
- Price: Trip fare
- Cost: Payment to the Rides Driver + averaged other costs
- Margin: Ride-hailing platform's take from drivers – averaged other costs
  - ♦ The take rate is not fixed.
  - ♦ Typically, Uber takes 30% of each fare, larger cuts from the luxury rides.[4]

- Uber announced 2019 full year Take Rate of 19.8%[5] and Uber Eats Take Rate of 9.5%. In 2018 the overall Take Rate was announced to be 21.7% (Uber) and 26% (Lyft).[6]
- An analysis of 14756 rides found overall Uber took a 35% cut of rides and Lyft took 38%. Over given time periods the average takes were 29.6% (Uber) and 34.5% (Lyft).[6]



- **Exhibit: A typical Ride-hailing process**

4. Winner-Take-All business? No.

- Positive network effect[7]:
  - Indirect: More Uber users – More Uber drivers – Less Waiting time – WTP advantage.
  - Direct: Split the bill / share the premium membership with your friend.
- Multi-homing cost:
  - For customer(rider)s: Very low. People can use both apps.
  - For drivers: There is some of it, e.g. authentication process, yet still low.
- Switching cost: No.
- Dramatic innovation: No.

Thus, the low multi-homing cost makes the ride-hailing business not a WTA model.

III Profitability Analysis

We focus on a segment of people who have higher WTP for ride-hailing service than Taxi because of the convenience, better vehicle, etc. These people are to Uber/Lyft's most concern.

So far, Uber runs globally while Lyft only covers certain city areas in U.S. For Lyft-coverage area, imagine without Uber, people still have Lyft. To determine the contributed value of Uber we investigate Lyft. For Non-Lyft-coverage area, we compare Uber with Taxi.

1. Unrestricted Competition

Assume the competition is unrestricted to apply the Contributed Value theory. In fact, uber can change its fare pricing dynamically. Basically Friction/Restriction are not significant in this case.

2. Source of Profitability – Contributed Value Analysis

- **Excess Demand**
  - **Lyft-coverage area:**

    The demand for Ride-hailing largely increases during rush hours or some other extreme weather when taxi availability lowers.

    Uber & Lyft's 'Surge' puts a multiplier on the fare amount, indicating ride-hailing platforms have abundant pricing power in this case. "A firm is guaranteed to receive a price equal to at least the willingness-to-pay of an excluded buyer." The pricing power comes from excess demand or say unserved customers.
  - **Non-Lyft-coverage area:**

    There are unserved customers. In some places there might be fewer Uber drivers than demand.
- **WTP advantage**
  - **Lyft-coverage area:** Slight WTP advantage.
    - The experience (app, ride, payment method) are similar.

- ♦ For each choice in Uber you can always find a match in Lyft, e.g. Uber Black – Lyft LUX.
- ♦ In the same level, Uber vehicle said to be better than Lyft's.
- ♦ Uber is still holding bigger market share. Because of the positive network effect, it might take less for people to wait, thus causing WTP advantage.

- **Non-Lyft-coverage area:** WTP advantage over Taxi.

- ♦ Upscale experience (e.g. Uber Black).
- ♦ (Probably) Less waiting time, more convenience.
- ♦ Safety concerns partly lower the WTP: allowing unauthorized drivers.[8]

- **Cost advantage:** Probably not.

  - **Lyft-coverage area:**

  From the Task Rate part, we know Lyft generally has a higher take rate from drivers than Uber. It means Uber's cost is higher.

  Although both sides may change the take rate in the future, the exploitation on drivers has aroused dissatisfaction. Uber might have some cost advantage in the operations for economies of scale. It has larger market share, so the marginal cost on computing capacity/ management can be lower than Lyft.

  - **Non-Lyft-coverage area:**

  Uber and taxi are not directly comparable in terms of 'Cost'. Taxi drivers get paid directly and the mechanism of a taxi trip is different.

3. Unprofitable War of Attrition?

As discussed above, in markets where Uber and Lyft coexist, the coexistence causes both companies to be of little contributed value – barely any WTP or cost advantage. Uber's contributed value lies in the excess demand, during rush hours in cities or in Non-Lyft-coverage area.

Uber is described as 'burn through cash'. Cash and equivalents increase over the years. The 'Growth Narrative' sounds like coming to an end as the revenue growth becomes slower while the cost becomes much higher.

The competition between Uber and Lyft has turned into a 'War of Attrition'. In FY2019, Uber's Total revenue up 25.5% from $US11.3b to $US14.1b, while EBITDA Margin was -56.3% and Loss from operations dramatically increased from $3.0b to $8.5b.[9] From 2015 to 2019, Uber has been suffering from loss. Lyft's net loss increased from $0.91b to $2.6b in 2019, while revenue increased from $2.16b to $3.62b by 67.7%.

It was believed that Uber and Lyft have been providing service at a price lower than cost (including the payment to drivers and the company level cost), to gain market share. Customers have been capturing more than the whole pie created.

4. Profitability soon

Despite the fact that Uber is suffering from huge loss continuously, according to Uber's announcement, in the 4th quarter of 2019, Rides Adjusted EBITDA delivered a $742 million profit and 24.3% margin, covering the R&D and SG&A cost, while Rides in 2018Q4 had an EBITDA of $195 million.[10] Eats, however, reports a worsened loss of $461m.

Exhibit: Segment Adjusted EBITDA, Uber 2019Q4

(in millions, except percentages)	**2018**	**2019**	**% Change**
Segment Adjusted EBITDA:			
Rides	$ 195	$ 742	281 %
Eats	(278)	(461)	(66)%
Freight	(23)	(55)	(139)%
Other Bets	(38)	(67)	(76)%
ATG and Other Technology Programs	(105)	(130)	(24)%
Corporate G&A and Platform R&D [(1), (2)]	(568)	(644)	(13)%
Adjusted EBITDA [(3)]	$ (817)	$ (615)	25 %

In 2019Q4, Uber Rides' Revenue increased from 2018Q4's $2.4b to $3.06b by 27%. Compare 27% and 281%, we can assert that Uber used bargaining skills: either lowered cost (or say increase the

take rate) or increased the price, or both.

Only looking at Uber's Rides (Ride-hailing) business, Uber has been able to breakeven or even make a profit. In 2019, the worsening loss from operations largely results from the investments in R&D. Therefore, it is possible that Uber's Ride-hailing business become profitable soon.

5. Sustainability of profitability

The Barrier-to-Entry for the ride-hailing market is clear: huge amount of fixed cost, technology, economies of scale, etc. It can be expected that in the few years to come, Uber and Lyft will be the duopoly of Ride-hailing market. No third player.

But one competitor is enough to make this business not sustainable in profitability at all: no WTP advantage nor Cost advantage (in Lyft-coverage-area).

Therefore, what strategies should uber take to achieve profitability and keep sustainability of business, could be a motivating question to figure out in the near future.

IV Current Strategy

1. Market Segmentation

Uber is intentionally targeting at long-distance trips. Lyft is Uber's largest competitor in the US market. Uber and Lyft both offer innovative alternatives to taxis and long-established private transportation services. Both give passengers a convenient and innovative way to request and pay for rides through their smartphones. However, they have considerable differences in their service areas, offerings, and culture.

Lyft pursued a differential positioning strategy as the "anti-Uber" and offered a peer-to-peer ride-share service. At the very beginning, Lyft did not provide a black-car service, instead, it offered a low-tier options called Lyft Line and Plain Lyft, similar to UberX, which seated four, and Lyft Plus for larger groups that included SUVs. However, at present, Lyft has adopted Lux, Lux Black and Lux Black XL, but there is not Lyft Line anymore.

Both Uber and Lyft have a spectrum of products. Here just compare the most popular ones: UberX and Lyft. Take NYC as an example.

In Manhattan south of 60th St., NYC, average Taxi speed is around 7.0 mph.[11] Some other resources suggested that typical taxi speed is about 16 mph. Here we consider the less traffic case so choose 16 mph. By combining the mile charge and the time charge, an additional mile costs $3.06 (UberX) and $3.99(Lyft). UberX has a base fare of $2.55 while Lyft does not. Therefore, the breakeven point is 2.74 mile. This can be interpreted as Lyft is a better choice than UberX in short-distance and less-traffic trip.

The difference in Per mile & Per minute pricing somewhat indicates that the two companies are targeting different market segmentations in terms of distance.

2. Geographic scope

Beyond the segmentation by trip type, the company-level market geographic scopes of Uber and Lyft are different. As mentioned, Uber aims at the global market while Lyft focuses on several domestic cities. Uber's U.S. market accounts for 58.1% of total by 2019-12-31 and the rest are in other countries.[9] Lyft's limited geographic scope can also be explained as the judo-strategy of the second mover.

3. Bargaining skill

Uber adopts surge pricing, a tactic that increased rates sharply in times of higher demand for car service. Uber has advantage in information asymmetry, between customers (Riders) and suppliers (Ride Drivers). By changing the fare price and take rate in a strategical way, Uber can capture more value. The 287% EBITDA growth and 27% revenue growth from 2018Q4 to 2019Q4 exhibit Uber's bargaining skill.

4. Horizontal Diversification: Uber Eats, Freight, etc.

Uber slowly added a delivery service (UberRUSH) and eventually created an application program interface (API) enabling an Uber button to be added to other organizations' apps (e.g., Facebook, retailers, florists) for delivery options through UberRUSH and UberEATS for food products.

Uber released its food-delivery service – Uber Eats, to form synergy hopefully. Dara Khosroshahi, Uber's CEO, thinks Uber Eats is a secret weapon in the ride-hailing wars.[12]

As a late mover in food delivery market, Uber Eats becomes another cash-burning business. Uber decided to exit markets like India where it cannot become dominant.

V Recommended Strategy

1. End the war of Attrition: share the market

Both Uber and Lyft should have realized they cannot own the whole Ride-hailing market, because the Ride-hailing market is not a Winner-Take-All market.

As the first mover in the ride-hailing business, Uber did not establish a structural advantage which could significantly lower the cost or increase the WTP. Uber is now aimed at seizing market share. It expands the incurred operation losses and deteriorate profitability in the near future, which is not beneficial to keep sustainability of business.

Thus, given the characteristics of ride-hailing market, we recommend that Uber should try to avoid the war of attrition, stop excessive expansion, focus on its core market (especially Non-Lyft-Coverage area where they have contributed value) and target customers. In addition, Uber should also allocate its resources and capital efficiently in external investment and horizontal integration, to achieve best synergy with its core business and drive revenue growth.

2. Vertical Integration: be the first mover in auto-piloting

Auto-piloting brings possibilities of driverless car, which can lower the costs for Uber. This is also an opportunity to start vertical integration along the industry chain, creating huge synergy and differentiation advantage.

Entering new market will help Uber to find new source of revenue and increase the sustainability of business. For auto-piloting market, its barrier-to-entry is relatively high, and the first mover advantage is clear.

Therefore, we recommend Uber to be the first mover in auto-piloting market, to grasp new chances of business and future profitability.

Citation

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