Topic in the News - Uber

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Youtube Video Link
https://www.youtube.com/watch?v=ujjPqauzJIA

Powerpoint Link
https://www.canva.com/design/DAEYPNwvxvc/X5tnELBmie5JtoxwPGLbDg/view?utm_content=DAEYPNwvxvc&utm_campaign=designshare&utm_medium=link&utm_source=sharebutton

News Link
https://www.bbc.co.uk/news/business-56123668

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Introduction

Uber Technologies is an America-based ride-sharing service provider. It is the dominant player in the ride-sharing sector and has horizontal subsidiaries that expanded to include food delivery, package delivery, couriers, and freight transportation. The ride sharing sector is an oligopolistic industry with few dominant players in the field, with Uber being at the top of the echelon. Uber operates by contracting with drivers and dispatching them based on a central algorithm, accounting for demand and supply on the fly. So far, Uber has achieved its success through an early adaptation of mobile platforms and through its networking effect. Nonetheless, as time passes, existing customers will become aware of this industry's competitive nature and will begin comparing prices among platforms. Existing contractors will also be inclined to work for multiple platforms simultaneously, given their independent contractor status.

To ensure its contractors would not work for other platforms, Uber made extensive use of the Uber Pro scoring system, which is a form of relational contract. The system uses a tiered structure that rewards drivers who have high customer ratings and high cumulative trips counts with priority pickup quotes that usually yield a higher profit or even tuition coverage, which encourages the drivers to provide a better service quality while refraining from working for other platforms. However, the relationship between Uber and its independent contractors have become strained as drivers in multiple countries are now demanding to be treated as workers and wish to be entitled to minimum wage, holiday pay, and other employee rights. In fact, the UK Supreme court ruled that Uber drivers are classified as workers rather than independent contractors in February. To have Uber's contractors transitioned, it would impose a hefty compensation bill upon Uber that it cannot afford with its existing business model.

Alternative 1: Status Quo

One straightforward option for Uber is to keep all the contracts with drivers in the relational form and remain status quo.

By maintaining the situation, Uber can keep its advantageous pricing structure. Uber serves as a platform connecting drivers and riders. Since all the Uber drivers register with their cars, the company does not have tremendous fixed costs purchasing vehicles for operation. This conduces to its low, competitive pricing and various vehicle types services compared to traditional taxi companies, which consist of Uber's sustainable competitive advantage. The status quo option will require no attached expenses for investment, and thus the company won't need to increase the price to breakeven. Notably, Uber operates in the ridesharing industry, which generally has a low-profit margin and intense price competition. Under the circumstances, Uber trades off its profitability for the market shares. It is not beneficial for the company to increase costs that consume the feeble profits. Besides, there will be no additional implementation issues with this strategy.

Despite the advantages, Uber could also be negatively affected by this strategy. Granted, Uber has successfully implemented this strategy for years and received large market shares. With accelerating complaints arising internally from the drivers, issues seem to originate in the credibility and clarity of the relational contracts. Drivers found a lack of ability to communicate with the company and started to doubt the future benefits that the company could bring to them. In other words, the company faces difficulties in developing a coherent mutual belief of potential benefits as the basis of the relational contract. If the company insists on remaining status quo, credibility problems will continue to accumulate and contribute to adversarial relations between drivers and the firm. Drivers will be less motivated and find cheating become much more alluring, leading to loafing and perfunctoriness. Additionally, Uber will have to spend numerous amounts of capital on settling labor disputes. Another threat of this alternative comes from potential rivalry actions taken in the market. With relational contracts, drivers will break the agreement when the value of their next best option has a substantial increase. If Uber's competitors, such as Lyft, decide to transform into a structure with better incentive programs, there is a risk that Uber may sustain a high turnover rate. Drivers with better qualities may quit and join rivalry companies, leaving less qualified drivers to stay in Uber. This will facilitate worsening Uber's reputation and consequently result in loss of profits and market share.

Alternative 2: Forming formal contracts

As drivers are not formal employees who can enjoy all the company benefits, the relational contracts between them and Uber could result in several potential problems. Thus, Uber's second alternative is to transfer all relational contracts with drivers to formal contracts.

At the first point, a formal contract would state a detailed policy of employee responsibilities, employment and health insurance, holidays and sick days, protection and regulation over dismiss, and much more. It is easier and more convenient for Uber to regulate and control the quantity and quality of riding service with clearly stated terms. The formal employees must obey the contracts' rules limiting their minimum working hours and service standards, while drivers also benefit from more stable job security and paycheck, and better working conditions.

Another advantage of formal contracts is providing access to resolve and reduce disputes between two parties, minimizing the time and expense spent on a courtroom battle. Drivers' rights could be better protected with the legal provision, resolving the news's central conflict — independent contractors even do not have the right to sue for unfair dismissal. Therefore, drivers can be motivated by all the benefits of formal contracts and create more value for the company. Besides, as a leader in the industry, this action may result in a wide range of revolution in the whole ride-sharing industry and gain a reputation for taking care of employees' rights. We can expect a foreseeable positive social appraisal and potential enlarged market share, which increase the value captured by Uber in the whole system.

However, this transformation of contractors may result in many extra costs that lower the company's overall profit. The employment and health insurance that the company is obligated to pay for the formal employees can result in huge spendings, including the expense on human resources, supervision, and legal service. Uber mainly differentiates itself from the traditional taxi and other competitors from lower prices and broader service range, and the higher cost would reduce uber's advantage on pricing competition and thus decrease the profit and market share.

Alternative 3: Training and promotion program

Uber could establish an internal assessment system to assess their drivers' overall performance and provide training and promotion opportunities to those with high scores. Some of the drivers have no choice but to work as drivers because they do not have a chance to learn other skills and techniques to find other better jobs. They actually desire to work at the office instead of driving cars for a living if they could have better chances. Uber could offer training programs such as fundamental computer science courses or data analysis courses to those drivers with excellent performance. After the training, Uber can hire internally for administrative or marketing departments from those who do well in the training programs. Suppose the drivers successfully get the job offer from Uber. In that case, they will become the formal employees with pension benefits, ensured stable monthly salaries and other compensation benefits enjoyed by other workers of Uber and are able to work at office if they want. This will be attractive to those who do not want to work as drivers and are searching for other work opportunities. As drivers at Uber do not have obligations to take orders, they might not be motivated to accept more orders. Therefore, Uber can specify the criteria for the internal assessment system that includes a number of orders the drivers take with an extra bonus in scores if the order is accepted during the special time (i.e. bad weather, traffic time, late night and early morning and etc.), the passengers' rating, monthly attendance rate, working age and etc.

Under this policy, drivers have a chance to become formal employees at Uber whose averages are about $114k per year, while the average wages for drivers are only $4368 per year. Uber forms a more effective relational contract than the status quo with its drivers as drivers are given more incentives to work harder and accept more orders today to gain a higher score in the assessment and then get training and promotion in the future. However, the benefit is not settled in a formal contract. Although competitors can easily replicate the strategy, this strategy has the first-mover advantage as it is hard for drivers to maintain high performance in several platforms simultaneously. Therefore, drivers are likely to stick to the platform which first introduced the policy, which means drivers would like to stick to Uber rather than switch to its competitors like Lyft. Moreover, Uber can also benefit from saving the cost to do market research because the drivers work closely with the customer of

Uber and might have more realistic insight about the market. Uber is able to get access to primary information provided by drivers and respond to market change quickly.

This strategy also has some drawbacks. There exist information asymmetries between drivers and Uber about who will have the training opportunities and promotion. Drivers do not know other people's assessment results, so they are uncertain about whether they will have the opportunities. It is hard for relational contracts to sustain if the information asymmetries are high, and drivers who do not get into the training program will gradually become unmotivated to gain a high assessment score. Besides, there are also potential risks to lose excellent human resources. Since those with new skills might want to find jobs at other companies and industries, Uber is likely to waste some training expenses as some drivers leave the company.

Recommendation

As the ride-sharing market gradually matures, we argue that one of the critical strategies contributing to Uber's current leading position in the market has been its cost leadership strategy. This is mainly manifested in Uber's existing business model in terms of having relational contracts between Uber and its drivers, which yields a considerable amount of cost reduction in this low profit margin industry. With rivals, such as Lyft, emerging in the market, price competition has become increasingly fierce.

After conducting comprehensive analyses on all three alternatives, our group believes that Alternative 3 would be optimal based on Uber's current situation and future prospects. In light of the recent legal battle, forming formal contracts as suggested in Alternative 2 may indeed resolve the issue at the present moment. Nevertheless, this alternative does not guarantee long-term profitability. Forming formal contracts with all the drivers requires additional expenses, which may undermine Uber's long-term growth and sustainability. At the end of 2018, there were approximately 3.9 million active drivers, according to Uber's official website. (Exhibit 1) If Uber adopts Alternative 2, the incurred costs would have "skyrocketed". Given the ride-sharing industry's attributes, this alternative should not be regarded as the first consideration for Uber. Also, the option of remaining the status quo as suggested in Alternative 1 is no longer viable as the problems of credibility and clarity, as well as the implications have already rooted. The legal battle would remain unless virtual changes are made. To fix these two problems, Uber should construct an updated relational contract with training and promotion programs as suggested in Alternative 3 which would significantly increase the benefit of cooperating because of the strong incentives. The internal assessment system allows drivers to receive periodic assessment results which is a form of communication with the company that can better enhance clarity and credibility. Moreover, drivers are incentivized to work harder by the future benefits, including becoming a formal employee, which not only provides the legal provision drivers may require, but more importantly, it remains the business model that is most suitable for Uber. Despite the potential drawbacks of this alternative, from a long-term perspective, Alternative 3 exerts minimal adverse effects on Uber overall. Moreover, based on our assumptions, the estimated costs for Alternative 3 are substantially less (approximately $376 million) than those of Alternative 2 which makes Alternative 3 more appealing in the aspect of cost reduction. (Exhibit 2 and 3) Ultimately, we conclude that Alternative 3 would be the best possible option for Uber among the three proposed options.

Appendix

Exhibit 1 Key Statistics for Uber as of 2018

(Source: Uber)

Exhibit 2 Estimated Costs for Alternative 2

Alternative 2 Estimation	
Insurance Payment Calculation	
Average month wage	$364
Annual wage	$4,368
Employer Insurance Contribution Rate	2.21%
Annual Insurance cost per driver	$97
Total Insurance cost	$376,818,624

Exhibit 3 Estimated Costs for Alternative 3

Alternative 3 Estimation	
Driver Selection Data Assumption	
Total driver	3,900,000
Full-time rate	6%
Full-time driver	234,000
% of drives more than 3 years	11%
Professional driver	25,740
Top driver	5%
Qualified Driver	1,287
Selection rate	5%
Final Selection	64
Estimated Training	
Training cost per person	$10,000
Total Training cost	$640,000

Refernces

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