CASE 04

Uber: Competing as Market Leader in the US versus Being a Distant Second in China

Jochen Wirtz and Christopher Tang

ABSTRACT

Uber allowed people to book and share rides in private cars via their smartphones. With its headquarters in the US, it operates in 60 countries and has a strong presence in the Asia–Pacific region. This case study explores Uber's development and growth, first in the US, then its global expansion and subsequent foray into China. Despite enjoying international success with deep penetration in major cities, Uber flopped in the Chinese market. What were the reasons for its failure in China, given its spectacular performance in many other countries?

INTRODUCTION

Uber was founded in 2009 by Travis Kalanick (current Chief Executive Officer) and Garrett Camp (Co-Founder) in San Francisco. Its business model rested on the use of an app to call for a driver at any time and location (*Exhibit 1*). Uber managed to build a spectacular network of drivers and passengers in just three years, thriving in what some people term as an "instant-gratification economy", powered by the smartphone as the remote control for life. "If we can get you a car in five minutes, we can get you anything in five minutes," Kalanick said[1].

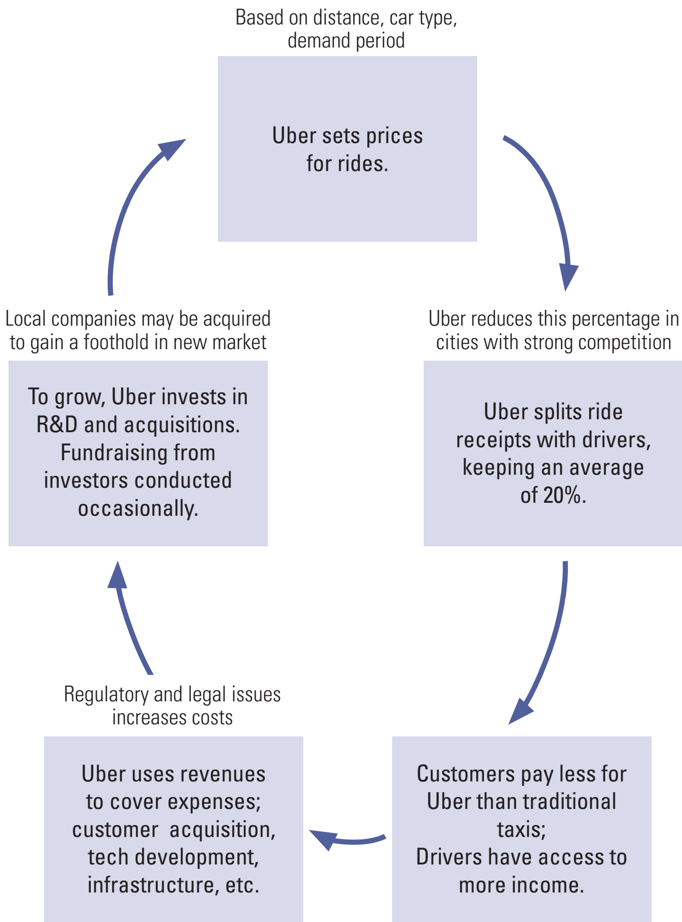

Exhibit 1 Uber's Business Model

Source

Forbes: http://www.forbes.com/sites/aswathdamodaran/2014/06/10/a-disruptive-cab-ride-to-riches-the-uber-payoff; accessed October 27, 2015.

 Jochen Wirtz is Professor of Marketing at the National University of Singapore, and Christopher Tang is a UCLA Distinguished Professor and the holder of the Edward W. Carter Chain in Business Administration.

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1 Vanity Fair covered an interview with Travis Kalanick in December 2014; this article's insights can be found throughout the Uber case study: http://www.vanityfair.com/news/2014/12/uber-travis-kalanick-controversy

Expanding outside of the US, Uber was a threat to taxi services in Europe and Asia, triggering protests in France, Germany, and India. Despite resulting government scrutiny, tighter regulations and disputes with local taxi companies, Uber's disruptive business model successfully posed an effective challenge to taxi monopolies in the countries it operated in. As of August 2015, Uber clinched the title of the most valuable startup in the world, valued at $51 billion.

Enjoying first mover advantage in app-enabled transportation services and ridesharing, Uber was far more successful in its number of users and drivers than its main American competitor, Lyft. Lyft positioned itself as a more informal, community-centered way to travel, with the expectation that drivers and shotgun-riding passengers would strike up a conversation during the ride. By being a late entrant to the market entering three years after Uber, Lyft managed to operate in only 65 American cities by the end of 2015. In contrast, Uber had been operating in a total of 300 large cities in 60 countries. Both companies offered a myriad of services at different price points (*Exhibit 2*).

China, with a projection of 221 cities containing a population of one million or more, was a highly attractive market for any internationally-minded taxi company. Uber pioneered its taxi service in Shanghai in 2013. Entering difficult markets was not new to Uber, which had previously successfully navigated diverse markets in the UK, India, and South Africa. Nevertheless, Uber encountered unique roadblocks in China — strong competitors, existing low-cost taxi services, and a lack of know-how to navigate around local regulations and even corrupt officials. Uber also faced tough competition from a much larger local player, Didi-Kuaidi (known locally as 滴滴打车). Didi boasted more than one million drivers in 360 cities in China, whereas Uber only had about 100,000 drivers in 20 cities.

Exhibit 2 A Comparison of Uber and Lyft's Services in the US

Uber	Lyft
UberX The least expensive Uber service. Seats four riders. Drivers use everyday cars that are 2,000 or newer	**Lyft** The lowest cost service. A request for a Lyft will send to you a four-seater car
UberXL Seats at least six passengers. An UberXL car will be an SUV or a Minivan. Higher fare price than UberX	**Lyft Plus** A car that seats six or more passengers. Slightly more expensive than Lyft
UberPOOL Share your ride with another person and split the cost	**Lyft Line** A ridesharing service that pairs you with other passengers who are traveling along the same route. Similar to a carpool
UberPlus/UberSelect A luxury sedan that seats up to four riders. Expect a BMW, Mercedes, Audi, etc., with a leather interior	
UberBLACK Uber's executive luxury service. Commercially registered and insured livery vehicles, typically a black SUV or luxury sedan	

Services are sorted according to fares in ascending order. Information adapted from http://www.ridesharingdriver.com

UBER'S GROWTH

The first conceptualization of Uber's business model started in Paris in 2008, when founders Kalanick and Camp could not get a cab after returning from a conference. The two discussed solving the problem with a mobile app — push a button and get a car.

In 2009, UberCab was born. After downloading its app, registering and entering credit-card information, customers could summon a car with the press of a button. G.P.S. took care of the location, and the cost was automatically charged to the customer's credit card, with tips included. It did not take long for the company to run into regulatory issues when the San Francisco Municipal Transportation Agency objected to the use of "cab" in UberCab's name a few months after its launch, given its operation without a taxi license.

After changing its name to Uber, things went on an upward trajectory. Valued at $60 million after only six months of operation, Uber received support not just from angel investors and venture capitalists, but also from prominent celebrities like Ashton Kutcher (founder of A-Grade Investments), Jay Z (co-founder of Roc-A-Fella Records), and Jeff Bezos (founder of Amazon).

Uber faced many obstacles and criticism in its early years. One criticism was directed at the "surge pricing" model, which referred to the practice of charging customers higher prices at peak hours. It garnered a lot of attention during a snowstorm in New York in December 2013, when rates increased up to eight times its standard rates, attracting a flood of negative publicity. Kalanick defended this practice with economics — it reflected demand and supply at any given point in time, and effectively allocated capacity to customers who were willing to pay even during super-peak periods. To ameliorate public outrage, Uber eventually tweaked its pricing model and limited fare hikes to a maximum of 2.8 times the normal fares in the face of snowstorms in New York[2]. Uber proudly announced in January 2015 that it had more than 160,000 active drivers in the US who provided more than a million rides a day.

Uber's operations covered 75% of the US population, and even as it sets its sights on international markets, it remained focused on growth at home. Its efforts were mainly channeled towards building a strong network of drivers and improving service for consumers. These efforts paid off — 40,000 US drivers joined Uber in December 2014 alone; service efficiency saw improvements with 91% of UberX rides arriving in less than 10 minutes in Philadelphia; and the demand for Uber peaked when people celebrate and consume alcohol, testifying to Uber's position as a "better late-night option". Uber also started to pay more attention to corporate social responsibility. For example, its program UberMILITARY led to the hiring of 10,000 veterans — ex-military personnel — as drivers, while the use of UberPOOL was calculated to save more than 13,000 gallons of fuel each month in San Francisco alone[3]. By stretching its network of drivers to different demographic segments in society, offering alternative ridesharing options and reducing waiting time, Uber was able to build on network effects for drivers and loyalty among consumers, making it difficult for competitors to enter and grow in its markets.

LYFT'S RISE AND RIVALRY

Lyft was founded in 2012 by John Zimmer and Logan Green, launched primarily as a low-cost competitor to Uber. Its focus was on short, urban rides. Lyft logged an impressive 2.2 million rides in December 2014, with revenues for that year estimated at $130 million. In May 2015, Lyft was valued at $2.5 billion[4], its promising growth bolstered by estimates of 2015 revenues to be $796 million, an impressive 512% jump from 2014.

While Uber touted its iconic black cars to differentiate its luxury services for professionals (*Exhibit 2*), Lyft adorned its cars with a pink moustache (*Exhibit 3*), which had become an identifying factor for the company when driving down the streets of San Francisco[5]. This was accompanied by the greeting of all Lyft passengers with a fist bump. While these tongue-in-cheek communications

2 The Guardian covered the revision in surge pricing by Uber in http://www.theguardian.com/technology/2015/jan/26/uber-surge-pricing-new-york-snowstorm

3 Uber Expansion, not officially affiliated with Uber, provides a range of statistics pertaining to Uber's expansion in this page: http://uberexpansion.com/2015-uber-data-stats

4 Business Insider website reported on the $2.5 billion valuation on 15 May 2015; the whole article can be found here: http://www.businessinsider.sg/carl-icahn-invests-150-million-in-lyft-2015-5/#.VicRavkrLIV

5 Wired Magazine reports on the changing of Lyft's most prominent quirks in January 2015, with reasons: http://www.wired.com/2015/01/lyft-finally-ditching-furry-pink-mustache

The original version of the carstache. Retrieved from http://cdn. arstechnica.net/wp-content/uploads/2012/07/Pinkout81-640x426.jpg

Lyft's new moustache, termed a "glowstache". Retrieved from http:// www.autorentalnews.com/fc_images/news/l-lyft-moustache.jpg

Exhibit 3 Lyft's Pink Carstaches

were successful in positioning Lyft differently, Lyft's top management announced plans to tone down the *carstache* and scrap the fist bump practice in January 2015. This decision was made with the realization that what worked in the West Coast would not work in Lyft's plans to expand to other cities in the US, or even internationally.

Regardless of Lyft toning down its practices, it still prided itself on its friendliness and laidback driving experience when compared to Uber. An internal presentation from March 2015 that was leaked to Bloomberg revealed its criticisms of Uber for its "top-down model", "exclusive mentality", and "anti-social culture"[6]. On the other hand, Lyft claimed its growth to be bottom-up and led by drivers through positive word-of-mouth marketing, 32% of whom were female. All in all, Lyft believed itself to be a "trusted brand" delivering a "social experience" with memorable quirks — the *carstache* being one of them.

Apart from its more relaxed brand image, Lyft mainly positioned itself as a lower-cost alternative to Uber. Since 2014, the company announced big price cuts — they first cut prices by 20% in early 2014 and then reduced them again by 10% in May[7]. Lyft also used a surge-pricing model; to ward off potential criticism, it provided discounts of 10–15% during off-peak hours. While both companies engaged in aggressive price cutting strategies whenever they operated in the same city, Lyft drivers typically charged — and earned — less than Uber drivers (*Exhibit 4*), which was consistent with Lyft's positioning of being a lower cost alternative.

While Lyft enjoyed strong branding and was expected to spend a generous 60.5% of its revenue on marketing in December 2015, its operations were not as entrenched as Uber's. One example can be seen in its attempts to break into New York's tight network of taxis in July 2014, where Uber had already operated for three years. A public exposé occurred, in which the company was issued a cease-and-desist letter by the New York State Department of Financial Services just days before it planned to open operations[8], for non-compliance with safety requirements and licensing criteria. Uber also aggressively cut the price of its UberX service by 20% that week, to price itself significantly lower than regular taxis just before Lyft entered the market. The bottom line of Lyft and Uber's rivalry was that the latter enjoyed a first-mover advantage and, having established a presence in major cities beforehand, benefited from network effects and sufficient margins which allowed it to cut prices when needed, to erect barriers to entry and slow down the growth of competitors. Uber's significantly higher market valuation also helped to raise more capital each funding

6 Eric Newcomer and Leslie Picker (2015), "Leaked Lyft Document Reveals a Costly Battle With Uber", Bloomberg Businessweek. Retrieved from http://www.bloomberg.com/news/articles/ 2015-04-30/leaked-lyft-document-reveals-a-costly-battle-with-uber

7 Vator talks about Lyft's model with respect to prices and Uber's response in 2 articles written in 2014: http://vator.tv/news/2014-04-24-lyft-takes-off-hits-24-new-cities-in-one-day and http://vator.tv/news/2014-03-18-lyft-counters-surge-pricing-by-reducing-off-peak-fares

8 To follow Lyft's saga in New York City in July 2014, the time period it decided to offer its services to Hong Kong, read Bloomberg Businessweek's exposé on the issue: http://www.bloomberg.com/news/articles/2014-07-10/lyft-not-authorized-for-new-york-days-before-start-due

Source
Adapted from http://time.com/money/3959091/uber-lyft-price-per-trip; accessed October 27, 2015.

Exhibit 4 Average Income of Uber and Lyft Drivers per Trip in Selected Cities.

round — it raised $1 billion in July 2015 while Lyft raised only half the amount in the same year. This helped sustain any losses in operations in an era of price cuts.

Finally, Lyft tried to expand fast — it raised $250 million in 2014 and another $530 million in March 2015, with the main goal of expanding internationally and entering less competitive markets without already entrenched competitors.

DIDI

In China, Uber found itself in the position of the much smaller late entrant. Here, Didi was the clear leader. Didi-Kuaidi, referred to as Didi by the public, was the product of a merger between Didi Dache and Kuaidi Dache, two of China's leading taxi-hailing apps. In February 2015, the merged entity was valued at $6 billion, and doubled to $12 billion by September in the same year[9]. Didi's services covered 80% of China's huge market of 800 million city dwellers (*Exhibit 5*), being a deep-pocketed dominant player reaping the network-leveraging dividends of having drivers and customers hooked on to its product early.

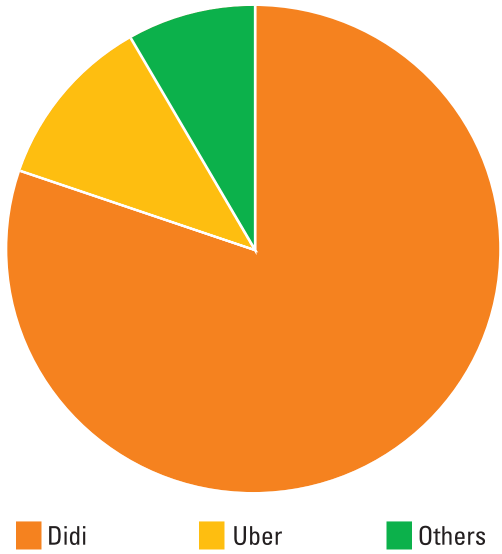

Exhibit 5 Market Share of App-Based Car-Hire Services in China

Source
Adapted from http://fortune.com/2015/09/30/will-china-be-ubers-waterloo, accessed October 10, 2015.

9 Gerry Shih (2015), "China taxi apps Didi Dache and Kuaidi Dache announce $6 billion tie-up", Reuters. Retrieved from http://www.reuters.com/article/2015/02/14/us-china-taxi-merger-idUSKBN0LI04420150214

Didi was also far more successful than Uber in the aspect of legal legitimacy, acquired from its local connections[10]. Didi enjoyed backing from powerful Chinese government investors, the most notable one being the China Investment Corporation, China's sovereign fund in charge of managing foreign exchange reserves. These well-connected investors opened up opportunities for Didi at the expense of its competitors, which included working with regulators. A success was commemorated in October 2015, when Didi became the first car-hailing app to be awarded an official license in Shanghai. This authorization was hailed as a landmark decision, allowing Didi to operate its ride-hailing business in the city without any fear of legal infringements[11]. It assuaged concerns among taxi drivers, as one revealed in September 2015, "I worry all the time about being caught and fined by the government. My biggest concern is policy uncertainties." With this formal recognition, more drivers were certain to sign on with Didi *vis-à-vis* its competitors, which could not provide the same level of regulatory security.

From the beginning, Didi pursued an aggressive strategy to lure as many drivers to its app as possible. Didi spent $700 million on rewards to taxi drivers between 2013 and 2014, attracting both new drivers and switching drivers from existing taxi companies with monetary incentives. So important were taxi companies as a source of growth that the sales team in Didi even went to the streets to promote their app to cabbies. By allowing its mobile apps to be used by taxi drivers as an additional channel to attract more passengers, Didi sought to convert these drivers to work for them exclusively during peak hours by offering more attractive rates and bonuses. This method of attracting and converting drivers with the use of incentives allowed Didi to swiftly convert a large number of taxi drivers, quickly scaling their operations in other cities. It also highlights the main difference between Didi and Uber's business model — Didi started out with taxi drivers adopting its app, before adding non-traditional transport services to its portfolio while Uber started out with the intention of disrupting the taxi industry itself by replacing its services.

10 Deborah Findling (2015), "What stands between Uber and success in China?", CNBC. Retrieved from http://www.cnbc.com/2015/09/15/what-stands-between-uber-and-success-in-china.htm

11 "In the race for legal legitimacy," (2015) *Wall Street Journal*. Retrieved from http://www.wsj.com/articles/chinas-didi-kuaidi-gets-license-to-ride-in-shanghai-1444288510?alg=y

Part of Didi's fast growth was also due to tweaking and expanding its business model to meet unique local demands. For example, urban dwellers frequently looked for a compromise between overcrowded public transportation and the high cost of driving to work themselves, which led Didi to introduce Hitch as a service offering in its app, which was a group ride-sharing service along preset routes. Hitch was for casual drivers who wanted to recoup some gas money and toll fees on their daily commute — by inputting their start and end points into the app, Hitch connected them with nearby passengers heading in the same direction, allowing them to share the ride. This was different from the more traditional taxi-type service as drivers had control over where the ride ended, and they did not make a profit off the service — passengers only paid for the cost of gas and tolls. This allowed for fares that were 30–40% lower than those of regular taxis. For Didi, Hitch encouraged consumers to try Didi's services at a low cost, therefore, opening a pathway for them to convert to the more expensive for-profit taxi service eventually.

Clearly, Didi understood the local market's needs well enough to carry out effective customer segmentation to target the differentiated needs in its product development. This allowed for the building of customer loyalty to the main corporate brand, and the greater willingness to try *and* switch between Didi's various services, depending on the occasion of travel.

UBER'S RESPONSE TO DIDI'S MULTIPLE SERVICE OFFERINGS

Uber had prioritized China as a key market for expansion, and it was befuddling to the company to be in a distantly second position. Uber to Didi in China was like Lyft to Uber in the US. In a cruel twist of fate, Didi recently invested $100 million in Lyft in September 2015, forming an international ride-sharing partnership.

Uber managed to capture only 11.5% of the Chinese market, but experts did not find it surprising given China's unique institutional structures. Greg Tarr, partner at CrossPacific Capital, commented, "When you have great technology and a great business model but don't understand some of those local business premises... West Coast aggressiveness will only get you so far. China is such a different animal in terms of dealing with the local culture, the protectionism and the fact that you don't have local investors." This demonstrated the need for

Uber to better understand the Chinese market, rather than merely transplanting its San Francisco model of attracting American drivers and dealing with local regulations. Uber thus attempted to work closely with China's Ministry of Transport by setting up servers in China, in an effort to obtain an internet service company license by sharing data with local transport authorities.

Reformation in Uber's marketing strategy in China was a priority, and steps were taken to set up local teams to localize logistics, including language and support services. At consumers' requests, Uber strategically partnered with Chinese search giant Baidu, ditching Google Maps for Baidu maps into its app. Baidu also prominently advertised Uber on its main page with a prominent "Get a Car" button, linking it to Uber's app. Partnerships with Alibaba also allowed Uber to use the simpler and non-credit card-based payment mechanism of Alipay[12]. This was important as many Chinese residents did not own credit cards.

Uber competed vigorously with Didi on many other fronts to attract drivers to sign on with their companies. Both offered bonuses for drivers who hit ride targets, in a bid to extend geographical coverage and reduce wait times. This was based on an industry-wide understanding that spending cash to build an operational base as quickly as possible leveraging on economies of scale was the only way to win in China. As Didi's President, Jean Liu, revealed, "By using subsidies to get more cars on the road… waiting times were shortened, fares became cheaper, more users were drawn on to the platform and drivers on the platform. We have already created such a virtuous circle of increased orders, customer retention."[13]

To try and respond more effectively to Didi's diversification of services, Uber looked beyond its typical car-ordering model that worked so well in other international markets. In August 2014, Uber announced the implementation of People's Uber, where drivers offered "non-profit" rides to carpooling passengers who only paid for the cost of gas and maintenance. This was Uber's version of Didi's Hitch, competing directly to attract people who wanted low cost rides.

Uber seemed to be playing catch-up rather than setting trends in the China market. The race to grab market share was critical because it was understood that whoever got ahead first would remain the dominant player for a long time. Uber had to decide how to effectively compete with a much larger competitor, where to side-step competition and innovate new services, and where and how to go head-on with Didi.

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12 The Market Mogul covers Didi's triumph over Uber in the Chinese market in a short read: http://themarketmogul.com/didi-kuaidi-crushes-uber-in-the-chinese-market

13 Financial Times reports on the intensive cash burning on subsidies in the China market by Didi and Uber in http://www.ft.com/intl/cms/s/0/e85cc5fa-5473-11e5-8642-453585f2cfcd.html#axzz3oPUktNrd

Study Questions

1. How could Uber retain its dominant position in the US market? Are there services and/or geographic niche markets where Uber should accommodate Lyft?
2. How could Uber effectively compete with Didi? Should it compete head-on in China, or should it side-step competition by focusing on niche markets through service innovation, and geographic expansion within China?

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