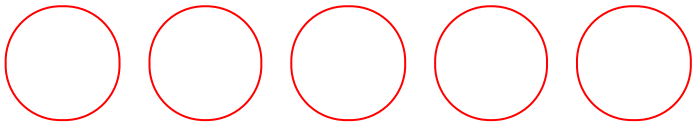
Uber’s Biggest Problem: Its Business Model



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Uber and its new leadership will have to come to grips with a fundamental vulnerability that is increasingly apparent in the company’s business model.

By

Christopher Mims

Memo to Uber Technologies’ next chief executive: The problems there may be bigger than you think.

Uber is currently trying to put out the fire that has culminated in the resignation of co-founder and CEO Travis Kalanick, a decision he made in the face of investor pressure following a damning report on its internal culture and missteps in its quest to be first to self-driving vehicles, among other problems.

But even when it steers through that thicket of crises, Uber will have to come to grips with a fundamental vulnerability that is increasingly apparent in the company’s business model. Uber may be great at technology, but unlike the businesses of Google, Facebook , Apple or Amazon, technology hasn’t proven to be a significant barrier to new entrants in ride-sharing. Across the globe, Uber has dozens of competitors, and in many markets they have grabbed the lion’s share of the ride-sharing market.

Uber co-founder and CEO Travis Kalanick has resigned, after investors pressured him to step down following six months of scandal and setbacks. Photo: AFP

Even if Uber fixes all of its current problems, it's increasingly unlikely that it can live up to the inflated expectations that come with the nearly $70 billion valuation that have made it the world's most valuable startup. There are barbarians at Uber's gate, and it's sorely in need of a moat.

Mr. Kalanick, who initially announced a leave of absence last week, wrote then that the company must evolve into "Uber 2.0", acknowledging it needs a complete overhaul of its corporate culture. But it's not clear how Uber the caterpillar becomes Uber the butterfly.

"We think the company's back is to the wall, and there is no more room for continued screwups," early Uber investor Mitch Kapor said last week. Mr. Kapor, who in February co-wrote an open letter to Uber about the company's "toxic" culture, suggested last week that Mr. Kalanick should only come back if he's "genuinely committed to Uber 2.0."

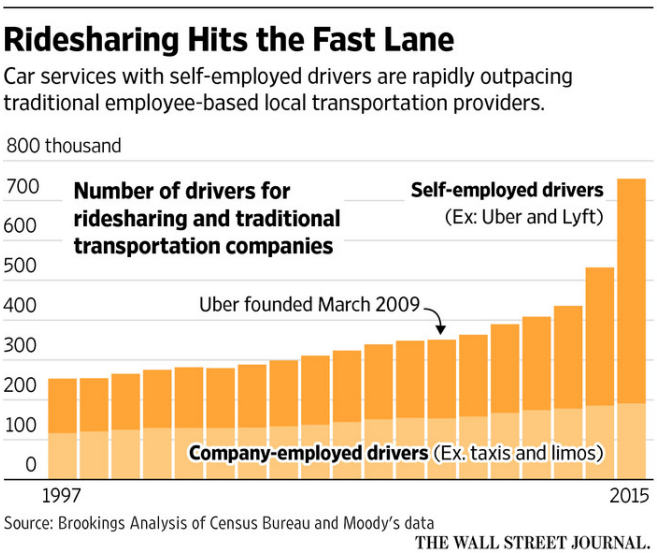
Assuming there is a magic pill to fix Uber's culture, the next step will be fixing the business.

Uber's original approach was more sprint than marathon. Believing he could pre-emptively wipe out the competition by amassing more money and market share early on, Mr. Kalanick employed a hyperactive management style that prized speed over integrity. But the finish line never really appeared.

Uber still believes that it has superior technology and data science that gives it lower costs per ride than competitors, says a source close to the company. If Uber is right and it can maintain an advantage like this in the long term, it could endure a long war of attrition with its competitors. But since neither Uber nor its competitors are public companies, no one knows the actual unit cost of their rides.

In the U.S., Uber's biggest competitor, Lyft, has rapidly closed the distance with Uber by some of the most important measures, and has reached that point with far less investment. Lyft is now in the same number of markets as Uber, and in major cities can match Uber on both price and speed of service, says a company spokesperson. Lyft's share of rides in the U.S. grew from 10% to 25% between June 2015 to June 2017, according to TXN Solutions, which tracks credit-card transactions. Lyft grew further with the grass-roots #deleteuber social-media campaign, launched in response to politics and allegations of sexism inside the company.

Uber's service is still better in the suburbs and commuter towns, but Lyft is starting to reach more of them, having added 150 markets in the past four months. Most important, both companies generate the bulk of their revenue in the biggest U.S. markets—not coincidentally, the markets in which Uber claims to have become profitable.



In China, another key battleground, Uber bowed out entirely. Uber continues to aggressively pursue international markets, but this growth is costing it dearly. Uber lost $708 million in the first quarter of 2017, despite $3.8 billion in revenue.

In some ways, Uber still has the wind at its back: Overall demand for rides is surging. Uber has said the number of rides it completed in the first quarter of 2017 tripled compared to a year earlier. Even if Uber continued to be the most notorious company in Silicon Valley, momentum—and its $7.2 billion cash hoard—should guarantee its survival. The danger is the company fails to meet the inflated expectations of its $68 billion valuation.

Google, Apple, Facebook and Amazon weren't first movers in their industries, but they had superior technology and infrastructure. Apple's brand and proprietary software and services gave it the pricing power to

generate huge profits. Google's search and ad technology outclassed its competitors. Facebook capitalized on the network effect that increased its utility as more people joined. Amazon got so good at building cloud services for itself that it started selling them to others—reaping huge profits.

And Uber? Aside from the cash, it's got a (tarnished) brand and an app that has been widely copied. Uber could once plausibly claim that the company with the most customers could support the most drivers, creating a virtuous circle where mass plus engineering might yield an unbeatable customer experience.

Now, the preponderance of its competitors, ably luring away customers and drivers, suggests that the ride-sharing market will come to resemble something far less sexy—and less profitable. Uber may just be a gigantic taxi company after all.

Uber aspired to be the dominant marketplace where everyone from drivers to self-driving car manufacturers would be forced to sell their services. It's now just as likely that Uber will be one of that industry's many players, competing in a race to the bottom on both price and service, says Carlo Ratti, the director of MIT's Senseable City Lab, who builds models of the future of transportation.

A logical response to all this competition would be vertical integration. Uber won't lock down its drivers with employee contracts, but it could (eventually) control a fleet of self-driving cars. It's still possible autonomous vehicles provide the moat that helps Uber reach tech-giant status, but there are plenty of reasons to believe they will hand the advantage to Uber's competitors instead.

Uber faces a huge opportunity to reform a company badly in need of it. But even if Uber can change its ways, the question for the company's board, employees and investors is whether it's too late for Uber to become more than just another ride-sharing company.

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Corrections & Amplifications

Lyft's share of rides in the U.S. grew from 10% to 25% between June 2015 to June 2017, according to TXN Solutions, which tracks credit-card transactions. A previous version of this article incorrectly stated that Lyft's share hit 25% in June 2016. (June 21)