

<https://pando.com/2017/03/10/yes-all-fowler-greyball-waymo-issues-are-reflection-uber-business-model-fundamentally-unfixably-broken/>

# Uber an avatar of innovation and progress? The economic evidence says otherwise.

By [Hubert Horan](#), written on March 10, 2017

**Yes, all of the Fowler-Greyball-Waymo issues are a reflection of an Uber business model that is fundamentally, unfixably broken. But the tech fanboy fantasy that Uber is an avatar of innovation and progress is immune to economic evidence.**

Uber has faced a torrent of bad publicity in recent weeks. Surge pricing actions that undermined protests against Trump's initial Muslim ban, Susan Fowler's blog about systemic protection for sexual harassers, the Google/Waymo lawsuit alleging theft of driverless car intellectual property, a Youtube video showing Travis Kalanick's arrogant response to a Uber driver's complaints about fare cuts and reports that Uber obstructed law enforcement in several cities using a system called Greyball.

Pando readers know this type of Uber behavior is not breaking news, as Pando had reported Uber's efforts to sabotage Lyft and other competitors, egregiously sexist ("boober") marketing campaigns in France, deliberate attempts to deceive drivers about their earnings potential, willful evasions of safety and insurance requirements, hiring ex-CIA operatives to dig up dirt on plaintiffs in a surge pricing lawsuit (and then lying to the judge about it) and l'affaire Sarah Lacy, the centerpiece of Uber efforts to intimidate critical journalists.

Unfortunately, the numerous stories about recent events have done little to help illuminate the underlying issues. Lots of dots, but what's the connection? Is this aberrant behavior that can be separated from a much healthier corporate core or is it the unavoidable consequence of fundamental core problems? Could a new COO or some other kind of outside intervention stop Uber from behaving like this in the future?

None of the articles can answer these questions, because answers require understanding the economics of Uber's core business model. This ignorance is not surprising; despite thousands of articles in the tech industry and general business press, there's been close to zero reporting about Uber's competitive economics. Why is Uber running multi-billion dollar losses? Does Uber have the kind of scale or network economies required to reverse these losses and "grow into profitability"? If Uber will eventually be able to produce car service more efficiently than the competitors it has been driving out of business? What exactly is the source of those efficiency advantages? What specific parts of Uber's business model do its investors think will eventually drive returns on its huge (\$13 billion) investment base?

If you want to argue that Uber's recent problems reflect aberrant behavior, or a fixable problem, you need to show that Uber's growth and valuation were driven by legitimately powerful economic advantages, that the various displays of misogyny, arrogance, and legal evasions (and the financial or cultural incentives that facilitated them) added little to those economics, and thus could be eventually expunged. This would require documenting powerful Uber competitive efficiency advantages and scale/network economies, and compelling evidence that sustainable profits, and investor returns are just around the corner.

Unfortunately, this evidence does not exist. The problem is that Uber's economic core is fundamentally rotten. Uber is not a good company that inexplicably developed a bad culture. The bad behavior is not the unfortunate byproduct of a company led by investors and managers capable of designing a strategy based on superior efficiency, but who happened to lack empathy and social awareness. Because Uber's investors and managers couldn't develop any legitimate competitive efficiency advantages their strategy was entirely based on ruthless displays of raw power. The bad behavior demonstrated over the years was central to that strategy. Uber rewarded and protected the people who could be the most ruthless towards regulators, drivers, competitors and journalists because they knew that ruthlessness was the driver of their growth and valuation.

**Need to justify Uber? Invent an alternate reality where the tech industry is always virtuous.** Ben Thompson's 7 March Stratechery piece "The Uber Conflation"

[<https://stratechery.com/2017/the-uber-conflation/>] illustrates how the "aberrant/fixable bad behavior by a fundamentally good company" argument requires willful ignorance of Uber's competitive economics. I'm using Thompson's piece as an example here because it illustrates how someone who is a smarter, more independent observer of Uber than most tech journalists, and clearly understands that many Uber actions have been inexcusable, still retreats into a fantasy world unhinged from economic reality in order to maintain the belief that Uber is a heroic innovator that represents the tech industry's devotion to making the world a better place. Thompson's piece starts by posing three reasonable questions:

*1: Is Uber a viable business that can one day go public, make a profit, and return the unprecedented amount of capital it has raised? 2: Is Uber's approach to regulation wrong? 3: Is Uber wrong with regards to the specific issues at the center of this controversy?*

I would make a small but critical adjustment to Thompson's first question to include whether the profits and ROI it might earn are consistent with improving overall economic welfare. Scammers and drug dealing and arms smuggling businesses might create strong returns to their owners, but create huge negative externalities for the rest of us, reducing overall welfare. Some tech unicorns are viable and increase overall welfare but not all of them; you need to look at evidence in each case. If Uber has a rotten core, the benefits it might create are overwhelming captured by owners and there are lots of negative externalities. If Uber has a non-rotten economic core, there will be strong, tangible evidence of societal welfare enhancements, in terms of the ability to sustainably produce more car service at lower prices, and in terms of substantial improvements in taxi industry efficiency, that clearly offset negative externalities.

Thompson sidesteps the critical first question to focus on the second. His central claim is that Uber's virtuous core is its effective nullification of taxi industry regulations, which hugely benefits society. Thus Uber is a fundamentally good/fixable company and it would be wrong to "conflate" Uber's regulatory disobedience, which Thompson sees as wholly legitimate and disregard of other laws (like sexual harassment) which Thompson clearly understands are

not. “Kalanick’s mistake was in not clearly defining, communicating, and enforcing accountability on actions that pushed the line but had nothing to do with the company’s regulatory fight.”

The problem is that Uber’s approach to regulation is a component of its overall strategy to become viable. You need tangible economic evidence justifying its nullification of regulations, and also need evidence that it helped create a viable company. Some regulations reduce overall welfare but not all of them do; you need to look at the evidence in each case, and you need to show that Uber’s specific regulatory fight benefits society, not just Uber’s owners. He has no objective, verifiable evidence of specific efficiency/welfare burdens imposed by specific regulations, and no evidence that Uber’s lawbreaking created efficiency/welfare gains. All Thompson has is a faith in virtuousness of Uber and the tech industry that is so strong that it eliminates the need to provide any verifiable supporting evidence, and automatically justifies the deliberate violation of democratically established laws that might interfere with private capital accumulation.

Thompson ignores substantial evidence contradicting his ideological presumptions about taxi regulation, including ample economic analysis showing why laissez-faire taxi markets will not optimize efficiency or consumer welfare, and real-world tests of deregulation in 17 cities failed to produce any efficiency, pricing or service gains. Taxi markets have lots of problems, but instead of looking at the industry economic data that would help explain them, Thompson just asserts (as Uber does) that some vague amorphous thing called “regulation” is the cause of all of them. (Thompson only support for his “taxi regulation is evil” claim is the wholly unsubstantiated assertions that algorithms controlled by a potential monopolist -- that neither Thompson nor any other outsider will ever be allowed to inspect-- do a far better job protecting safety than any government regulation could.)

I assume most Pando readers are aware of the major Uber economic issues, but my Naked Capitalism series provides detailed documentation on Uber’s [lack of profitability and predatory behavior](#), its [uncompetitive costs](#), its false claims about innovation and [competitive advantage](#), and that investor returns always depended on [industry dominance and anti-competitive market power](#).

One does not have to immediately accept all of those conclusions to see that Thompson’s various claims suggesting that Uber might someday have a viable welfare enhancing business are not backed by any hard evidence about efficiency advantages or sustainable profitability. All of Uber’s growth has required massive investor subsidies--\$2 billion in 2015 and \$3 billion in 2016. All of these subsidies have been destroying competitors who are more efficient but can’t withstand years of subsidies from Silicon Valley billionaires. Thompson argues that Uber has grown total market demand and offered greater service options at night. True, but all due to unsustainable predatory subsidies. Thompson says that Uber’s app gives it the great competitive advantage of controlling its customers. False—people don’t like Uber because the app has a neat user interface, people like Uber because the app shows more cabs at lower prices than competitors can offer. All of those cabs and low prices are due to unsustainable, predatory subsidies. Thompson insists “the fact remains that both Uber riders and drivers continue to vote with their feet” justifies his belief that Uber’s approach to regulation is right, but again ignores that they are not voting for the more efficient producer, but for massive service subsidies. Thompson is falsely claiming that Uber’s growth reflects the free choice of consumers in a

competitive market. Uber's predatory subsidies are designed to undermine the processes by which competitive markets help allocate resources, and then to eliminate competition altogether.

If these benefits were created by legitimate efficiencies, as Thompson imagines, there would be evidence showing how they made Uber more cost competitive, or how they similarly transformed competition in other markets. To refute the points here about Uber's predatory, market-distorting subsidies, Thompson would need evidence that Uber has scale economies powerful enough to quickly convert \$3 billion operating losses into sustainable profits, and evidence that Uber has competitive advantages overwhelming enough to explain driving everyone else out of the industry. Since Thompson does not have any of this evidence, he can't claim Uber has produced benefits for anyone but itself.

**Ruthless displays of power is central to Uber's competitive strategy.** If you start with evidence about the actual economics of Uber and the taxi industry, it becomes clear that all of Uber's ruthless, arrogant, "we are above the law" behavior was (and is) central to their business model and they could not have achieved their huge growth and valuation without it. None of it was aberrant; just as Uber developed a brilliant strategy to drive more efficient taxi operators out of business, it established a corporate culture that is totally aligned with its business model.

Thompson correctly notes that "Uber has collectively made a lot of decisions that push the line and been amply rewarded;" but still wants to believe they could make fine-tuned distinctions among these decisions in the future. But he also notes that "to Kalanick it was all one-and-the-same" and Kalanick—who understands Uber's business model better than anyone—is right. Since Uber was a less efficient producer, and had no meaningful competitive advantages or scale/network economies its entire strategy depended on using its massive \$13 billion investment to fund predatory behavior, demonstrating that it would be utterly ruthless in pursuit of global industry dominance, and getting the tech industry media to tell the world that its success was inevitable and resistance would be futile. If the media believed that the competitive battle was decided before it started, there'd be no need to investigate bothersome economic issues like efficiency or profitability.

This strategy required a fanatically dedicated senior management team; as [Brad Stone's Uber book](#) points out, by early 2011 Kalanick had "expelled from his inner circle anyone he thought might stand in the way of Uber's manifest destiny to conquer the world." Susan Fowler clearly illustrated how senior Uber people who had demonstrated their total dedication to Uber's ambitious objectives could freely break the law and company rules. Greyball, like the prior competitor sabotage and journalist harassment, show that senior Uber staff could go to absolutely any length to frustrate and intimidate government officials thinking that Uber's freedom to maximize shareholder wealth could be constrained in any way. As Pando has pointed out many times, no Uber executive was ever disciplined and no Uber investor ever criticized this behavior.

Those incidents—along with things such as extreme surge pricing, refusal to obey insurance regulations, unilateral moves that piss off drivers—are often criticized as foolish business practices that create negative publicity and alienate potential supporters without having any meaningful near-term P&L impact. But all of these actions are perfectly aligned with Uber's long term need to exploit the anti-competitive market power it needs to generate investor returns. To maximize long-run rent-extraction potential, it needs to establish today that it can disobey any regulations it doesn't like, it can use surge pricing to gouge customers without limits, (as

Kalanick bluntly explained to his driver in the Youtube video) it can impose any conditions on drivers it wants, and it can obstruct any local efforts to investigate its lawbreaking.

Travis Kalanick has that monomaniacal focus, and he established a corporate culture with that monomaniacal focus. As a direct result of that strategy and that culture you get obstruction of justice, theft of intellectual property, systemic protections for egregious sexual harassment, deliberate attempts to deceive drivers about their earnings potential, willful evasions of safety and insurance requirements, competitor sabotage and journalist intimidation. More importantly from an overall economic welfare standpoint you also get the massive resource misallocation that results from replacing existing industry capacity with less efficient Uber capacity, and major wealth transfers from drivers and consumers to Uber investors as it exploits anti-competitive market power.

Thompson calls Travis Kalanick “one of the most effective CEOs tech has ever seen.” I would agree. He has created \$68 billion in value pretty much out of thin air. He has achieved massive scale without having any competitive efficiency advantages whatsoever, and without creating any economic welfare benefits for the rest of society. Thompson still clings to the Silicon Valley tribal faith even though he’s starting to notice that the tech industry is “full of investors and companies that are utterly ruthless when money is on the line, while cloaking said ambition in fluff about changing the world.” This problem predates the tech industry by a few centuries. But the tech industry tribal faith has developed techniques for not only framing everything in emotive “we are heroically changing the world” terms, but also effectively block any of discussion based on objective evidence of economic welfare impacts that could cut this problem down to manageable size. As Sarah’s article yesterday documented in detail, it also manages to find ways to excuse or divert attention from the massive, growing base of negative evidence that could shatter the tribal faith.