

The uber economics:
an online
transportation
company that has
disrupted the indus...

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David vs Goliath: The Economics of Uber

Recently, San Francisco startup company Uber has caused quite a stir in the transportation industry. Its innovative use of loosely-organized, independent ridesharing has driven a thorn into the side of taxi companies, and threatens to dismantle the status quo of oligopolistic transportation.

In cities like New York City, taxis are big business. Any film set in the Big Apple is incomplete without an iconic yellow cab. Some may not know that in order to join the ranks of these urban fleets, prospective drivers must pay incredibly high fees to acquire licenses, much like franchisees of, say, fast food restaurants. These fees range from several hundred thousand dollars to potentially over one million, depending on the city. On top of this, local governments often set strict quotas on the number of taxis allowed to operate within city limits, as well as require a system of background checks and other verifications for drivers. All these factors constitute extremely high barriers of entry to this industry, which is inherently representative of an oligopolistic, or even monopolistic, structure. On the other hand, Uber allows its freelance drivers to enroll in its system for free, and is not yet heavily regulated by government, due most likely to its newness. The incredible ease of becoming an Uber driver, as well as the lack of individual advertising, marks a very drastic shift from the taxi model, and pulls the market style from oligopoly to almost perfect competition, because though the market may now be seen as Uber vs the taxi companies, Uber is comprised of thousands of independent drivers who are not actually employed or even

strongly controlled by the company. Because of this, each individual Uber driver could be essentially seen as a competing firm.

This radical, sudden shift in market dynamics has aggravated taxi drivers and firms for a number of reasons. Firstly, each driver had to, as aforementioned, pay hundreds of thousands of dollars for their license. The driver's taxi license represents their capital investment into what is essentially their franchise of the cab company, and with Uber undermining the very system of licensing, drivers who paid so dearly are now left with licenses worth much less secondhand than they initially paid. Secondly, and somewhat harder to sympathize with, taxi companies are frustrated with the sudden competition they have, and how it compels them to provide better service. Uber wait times are typically lower for consumers than are taxi wait times, and service is often better. Also, until legislation was passed in California reigning in the advantage, Uber drivers were not required to have anything but standard car insurance, whereas cab drivers are required to have more expensive commercial insurance. In order to draw consumers away from Uber and back to standard taxis, the taxi companies will likely have to engage in price competition, thus decreasing the difference between price and ATC, and bottlenecking revenue. In the long run, governments will have to decide what balance between protecting taxi companies and promoting competition and innovation is optimal for the welfare of society.

One aspect of the Uber system that customers often complain about, but which makes quite a bit of sense economically, is surge pricing. Under certain conditions, Uber will place a multiplier on its rates. One example of

this was during a snowstorm in New York, during which Uber rates were sextupled. The rate, though seeming to some to be ruthlessly opportunistic, helped to preserve an equilibrium of supply and demand. The increased revenue motivated drivers to get out and provide their services despite the harsh conditions, thus providing a supply of transportation to fill the demand of stranded consumers who were willing to pay. To some people freezing in downtown NYC, almost no price is too high to be able to get home safely and warmly. Surge pricing is a very interesting exploitation of temporarily inelastic demand: sextupling prices during say, June, would likely send customers running, because their demand for transportation is rather elastic. Weather is presumably rather warm, and walking, biking, and rollerblading are all reasonable options, as too is taking a cab. However, in the heart of a snowstorm, when most taxi services aren't running and it's too dangerous to walk, there are so few options available that demand for transportation is much less elastic than before. With that inelasticity comes power, and Uber and its drivers use that power to drastically increase their revenue.