Uber's battle for China

The car-hailing app has disrupted taxi and transport companies around the world. But in China – home to hundreds of millions of urban commuters – it is losing $1bn a year in an aggressive fight for market share.

By Leslie Hook
Photographs by Zeng Han
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In Uber's new offices in Guangzhou, China, occasional screams of delight erupt from the workers at their desks as they spot the office cat, a shy thing that mostly hides under furniture and causes uproar whenever she appears. Her name is Qianwanliang, or "10 million rides". It's a rather grand name for such a timid creature but this is Uber, and ambition is inescapable – even for office pets. "It represents some of our trip goals," admits Cleo Sham, a spiky-haired thirtysomething who has helped to turn Guangzhou, home to 12 million people in southern China, into Uber's busiest city globally. When she joined a year and a half ago, the Guangzhou office was a room of just 180 sq ft.

"Three of us were crammed into a room, day and night," Sham says with a touch of nostalgia. She handed out flyers, made cold calls, ran marketing booths. No one in Guangzhou had heard of Uber, and many people she approached would confuse Uber's Chinese name, Youbu, with Youku, a Chinese video service. "There was a lot of scepticism, a lot of rejections," she recalls.

Cleo Sham
General Manager of Uber Guangzhou

Name recognition is no longer a problem. China is now Uber's largest market, accounting for more than a third of its business in terms of weekly trips. It is Uber's biggest bet, and also its toughest market: the company loses more money here than anywhere in the world. Last year, losses in China came to more than $1bn (https://next.ft.com/content/f889f812-d664-11e5-829b-8564e7528e54), and they are set to be at least as high this year, as Uber fights for market share against its powerful Chinese rival, Didi Chuxing.

The drive to conquer the Chinese market comes directly from Travis Kalanick (https://next.ft.com/content/9b83cbe8-d5da-11e3-83b2-00144feabdc0), Uber's 39-year-old chief executive, whose aggressive personal style has defined the company's rise. Kalanick founded Uber in San Francisco six years ago with his friend Garrett Camp; the two originally envisaged a phone app for summoning limousines that would allow people to simply "push a button and get a ride". Since then, the company has grown into a personal car service that has disrupted taxi and transportation companies around the world.

Uber now operates in 68 countries, but China was always special. "Travis was personally invested in the success of Uber in China to a much greater degree than any other country," recalls Allen Penn, a 32-year-old American who is head of Asia operations at Uber. Last year, Kalanick spent nearly one in five days in China. In other countries, the company hires local chief executives, but here Kalanick maintains a hands-on role as chief executive of Uber China.

The company's adventures in the country started just over three years ago, when Kalanick, Penn and a few top lieutenants took a scouting trip to try to figure out how Uber could avoid repeating the mistakes of other foreign tech companies. Most Silicon Valley tech giants, from Facebook and Google to Amazon, have met

Travis Kalanick

Uber chief executive

with failure in China, for reasons ranging from censorship to IP theft to government regulations that favour domestic champions. But Uber has always believed in its own exceptional status. "We like to go after the thing that seems impossible," Kalanick tells me. "It was pretty far-flung for us to try at that time – but that was also what made it exciting."

Uber decided on a China strategy that was unlike anything it had tried elsewhere. It would set up a separate Chinese entity, Uber China, which would court local investors as well as getting financial support from the global Uber business, which holds a large undisclosed stake in the subsidiary. The hope was that a Chinese company could avoid some of the restrictions faced by foreign businesses.

At the time of that scouting trip, Uber was a relatively small start-up. It had just over 100 employees, operated in 10 countries and had raised a cumulative $50m from investors. It was far from obvious then that the car-hailing app would become the global juggernaut that it is today – the most funded start-up of all time, with a private market valuation of $62.5bn. Its most recent cash injection, announced earlier this month, was a $3.5bn investment from Saudi Arabia's sovereign wealth fund. It is also in talks to raise as much as $2bn in debt, which could bring its war chest to more than $13bn.

"We came to China and people just called me crazy," Kalanick said in a speech in Beijing in January. "And maybe we still are."

Uber was so focused on avoiding the pitfalls of western tech companies that its Chinese competitors – who simply offered traditional taxi services through apps – must have seemed like a sideshow during that first trip. In early 2013, China's two largest taxi apps, Didi and Kuaidi, were just small companies with business models completely different from Uber's.

But as Didi and Kuaidi grew, they went to war with each other, showering subsidies on taxi drivers and riders as they fought for market share. The subsidies were so generous that sophisticated scammers developed software to exploit them. Didi and Kuaidi were marking the playing field for what would later become the world's most irrational ride-hailing market, and the rules of the game were largely set by the time Uber joined the fray.

In terms of its transport infrastructure, the Chinese market had many elements that made it ripe for disruption. Rapid urban migration has seen hundreds of millions of people pour into new cities over the past two decades, and transport options have not kept up. Taxi ranks have failed to keep pace with economic growth, making it hard to find a cab in certain cities. Gridlock and pollution are the result – problems that Uber proposes to help solve.

Uber's formal launch in China came in February 2014, with the introduction of luxury car services in three Chinese cities: Shanghai, Guangzhou and Shenzhen. There were plenty of speed bumps, including the fact that Google Maps, which Uber uses to locate drivers and riders, is blocked in China, forcing the company to redesign its software. That autumn, Uber expanded its offering to include a cut-price service, People’s Uber, which allows anyone who clears a background check to offer rides in their personal vehicles. By the end of the year, Uber had captured about 1 per cent of the Chinese ride-sharing market.

Meanwhile, Didi and Kuaidi’s subsidy war eventually drove them into each other’s arms, and they announced a merger in February 2015.

Today, Didi Chuxing (known as “Didi” in China) is by far the largest ride-sharing group in the country, and the best capitalised. Last year it raised more than $2bn from investors including Tencent, Alibaba and China’s sovereign wealth fund, CIC. It has just closed a fresh funding round (https://next.ft.com/content/3d76ffe4-3301-11e6-ad39-3fee5ffe5b5b) of $4.5bn from investors including Apple, in addition to a $2.8bn debt facility.

Didi has operations in more than 400 Chinese cities and is profitable in half of those. Uber initially focused on China’s largest cities and is now in more than 50, with a plan to reach 120 by September.

One immediate result of the merger in 2015 was that Didi and Kuaidi started spending less on taxi subsidies, and instead took aim at the private car-hailing market. Their subsidies for private car rides soared, costing the newly combined company $270m during the first five months of the year.

The use of subsidies turned Uber’s business model on its head. Typically, Uber takes a cut of about 25 per cent of the passenger’s fare and passes the rest of the fare on to the driver. Costs are kept low because Uber doesn’t employ the drivers, or own the cars. However, in China, Uber pays drivers a multiple of the passenger’s fare, meaning that the company loses money on most rides. Other Chinese ride-hailing companies employ a similar strategy.

Didi and Uber blame each other for the game of subsidy one-upmanship that has come to define the Chinese ride-hailing market. Usually, “Uber doesn’t really do this type of thing,” says Kalanick. “But we are the number two in China and we have to, in some ways, follow the lead of the number one.”

Meanwhile Didi paints its subsidies as purely defensive. Didi is “quite profitable” in cities where competitors’ subsidy practices are less aggressive, says Stephen Zhu, vice-president of Didi. “The reality is that subsidies are used to compensate for an inferior user and driver experience,” he says, without mentioning Uber by name.

The subsidies are pernicious, not only because they drain cash, but also because they mask true levels of demand and supply. "You can go out, spend a bunch of money in a city and gain some market share, but that's not real," says Penn, Uber's Asia business head. "You're just kind of buying all of it – [though] you're really more renting than buying."

Many drivers for Uber say they would not be driving if it weren't for the bonuses, while passengers also say they would ride less if the services became more expensive. "I used to use Didi most of the time, but I switched to Uber because it was cheaper," said Xu Desheng, a 32-year-old living in Beijing, who says he has become a daily Uber user because of the prices. While Uber's services include luxury cars, cheaper rides are a bulwark of Uber's business in China. Uber's carpool service, with fares as low as Rmb2 (21 pence) accounts for more than half of rides in several key cities.

"Is Uber legal in America? Because it isn't here," says a 21-year-old driver in Beijing, surnamed Dong, the proud owner of a sedan that his parents helped him to buy.

It's a question asked by almost every Uber driver when they carry a foreign passenger. Dong tells me that his brother was picked up by traffic cops while driving an Uber just a few days before, and was fined Rmb20,000 (£2,100) – roughly two months' salary. As we approach my destination, a train station, he nervously tucks away the phone running the Uber app, then asks if he can drop me a few blocks away. Drivers are constantly sharing info about new traffic-cop checkpoints, and Beijing South Station was on the list that day.

Most Chinese drivers believe Uber is illegal (yet drive for it anyway), but the company is not technically banned in the country. In some ways, Uber’s rule-breaking ethos fits in with China’s rough-and- tumble economy, where entrepreneurialism is prized and bending the rules is normal. Kalanick says that, “China has been one of the most welcoming places we do business.” While that may be a slight exaggeration, it is true that the occasional police raids on Uber offices in China are minor frustrations compared to the outright bans Uber has faced elsewhere (https://next.ft.com/content/3d65be7a-2e22-11e6-bf8d-26294ad519fc).

Liu Zhen
Head of strategy and government relations, Uber China

“There are a lot of grey areas,” explains Liu Zhen, Uber China’s head of strategy and government relations, referring to the regulation of ride-hailing. “I wouldn’t say that it is not legal, it is in the process of being legalised.”

Liu has become the face of Uber in China when Kalanick is not around, and one of her prime tasks is to make sure that the “process of being legalised” goes as smoothly as possible. Beijing is working on a set of regulations that will completely redefine ride-sharing in China. An initial draft of the rules, published by China’s ministry of transport in October, proposed the potentially devastating move of banning ride-sharing in private cars.

Uber and Didi were both fairly quiet when the new rules came out. But within the government, there was pushback. “Innovation” and “the sharing economy” have become buzzwords at the highest echelons of the Communist party, and the new draft regulations were hardly in keeping with that spirit. The State Council, China’s cabinet, asked the ministry of transport to revise the regulations, sparking a debate that is still going on.

After China's decades of economic reform, embracing the sharing economy is a small step in the broader transformation to a market economy, says Liu Yuanju, a Shanghai-based economist. "There's a lot of will to support innovation," he says. "There are parts of the government that definitely want to embrace this [the sharing economy] but they also face a lot of pressure."

He explains that the ride-sharing rules are just a bit part in a much larger drama, as a behind-the-scenes struggle between conservative and innovative factions within the Chinese state plays out. China's premier, Li Keqiang, has made innovation a key part of his agenda, and has personally met Kalanick, as well as Didi's founder, Cheng Wei.

So far there have only been a few hints as to what the new rules might contain. In March, China's transport minister delivered a blistering critique of the ride-hailing subsidies, calling them "unsustainable" and "unfair" to taxis. However, he also acknowledged that private car services were popular, and hinted that they could be formally legalised after some type of driver-registration process.

Zhou Hang, the founder of the ride-sharing start-up Yidao Yongche, says he expects ride-sharing in private cars to be permitted under the new regulations – but that the number of these cars will be "very limited". He expects the cheapest type of ride services will be the most affected, which could spell bad news for Uber. However, few analysts expect that Uber's foreign roots will mean it faces special barriers. "It's very different from Facebook or Twitter," says Liu, the economist, referring to the services banned in China because of censorship.

Zhang Yi, the CEO of iMedia, a Guangzhou-based consultancy, points to Apple, which draws a quarter of its sales from China. "Why did Apple succeed [in China]? It's because they were purely about business," he says, waving his iPhone in the air. Uber's business doesn't touch on sensitive topics such as national security, he says, adding that its devolved corporate structure helps. "Didi has foreign investors, and Uber China is independent, so in terms of the shareholders there is basically no difference." Uber has already nodded to any data concerns Beijing might have by storing riders' information on local servers in China.

While questions about ride-sharing rules hang in the air, Uber China is also grappling with a different threat: fraud. China has the most sophisticated ride-hailing scams in the world, in which drivers and hackers milk ride-hailing companies for bonuses without carrying actual passengers.

The scammers have even developed their own lexicon, to make it easier to communicate covertly in online forums. A fake ride is known as "getting an injection", a reference to the red location pins in the Uber app. "Hey, give me a shot," a driver will post – and then a scammer, who typically advertises themselves as a "professional nurse", will respond.

The scammers create a fake passenger account that will appear to take a ride with a driver – who gets the bonus. About 3 per cent of Uber's rides in China were fraudulent during the summer of 2015 – about 30,00 daily rides – and fraud continues to be a problem.

Uber managers spend hours each week checking driver logs for fraud patterns and deciding which drivers to deactivate. "Every Monday is pay day, and fraud day," recalls a former Uber employee, explaining that fraud reviews happened just before drivers are paid. When he worked at Uber, in 2015, "The frauds that got caught were the really severe cases... only those who do hundreds [of fraudulent trips] per week."

Uber says it has improved at fighting fraud. "We have some of our smartest engineers working on this problem," says Tiger Fang, who heads Uber's operations in Chengdu, and has himself dived into some of the scammers' online chat-rooms, posing undercover to ask about their methods. There's a team of 50

Tiger Fang
General Manager of Uber Chengdu

engineers at Uber headquarters in San Francisco that focuses on fraud detection, as well as local manual review teams in each Chinese city. Uber recently introduced additional identity verification features – such as voice recognition for passengers and facial recognition for drivers – in an effort to cut down on fake accounts.

Fraud levels are falling not only because of these efforts, but also thanks to the fact that subsidies have been greatly reduced, lowering the financial incentives for fraudsters. Uber says it has cut subsidies in China by 80 per cent on a per-trip basis over the past year, while the volume of rides has risen by 16 times during that same period.

This trend is a key part of Uber's argument for why it can eventually succeed in China without subsidies. Fang, the Chengdu manager, explains that the subsidies become less important as Uber's network grows and drivers can carry more passengers per hour. "The more rides we do, the less money per trip we are losing [on subsidies] because we are increasing efficiency through the overall system," he says.

But removing subsidies altogether will not be easy. Examples from other markets show that heavily subsidised businesses sometimes just evaporate once the subsidies disappear. The taxi-hailing business of Didi and Kuaidi, which was initially fuelled by subsidies, is now a tiny fraction of their merged business and generates no revenues. Smaller ride-hailing companies in other markets, such as EasyTaxi in Jakarta, found that their business dried up completely when subsidies ended.

Cutting subsidies is particularly hard for a company that, like Uber China, is not the market leader. Market share figures in China vary greatly depending on who is counting – Uber says it has more than 30 per cent of the ride-hailing market, while Didi says it has more than 80 per cent – but everyone agrees Uber is far smaller. Having the greatest market share confers a huge advantage in ride-sharing, because the quality of the product improves as more drivers and riders join the system: passengers don't have to wait as long and drivers can make more money. This "network effect" is the reason ride-hailing companies are willing to spend everything to gain dominance in a market.

How much Uber will keep spending in China to fight for that market share is a key question. Unlike in other countries, Uber China is a separate entity with plans for an independent IPO, and it does its own fundraising in addition to getting cash from Uber Global. Last year Uber China raised $1.2bn after a prolonged fundraising effort, at a valuation of $7bn. However, it would not disclose how much of that was from investors and how much from Uber's own coffers – nor what Uber's stake in Uber China is. (The company says only that it is the "largest" shareholder in Uber China.) The fundraising did succeed in attracting some high-profile Chinese backers, including HNA Group and Guangzhou Auto.

Kalanick says Uber also uses its profits from other markets to support investment in China, but won't say by how much. Since February, Uber has been profitable, excluding interest and tax, in North America, Australia and in its Europe-Middle East-Africa region.

But there are other demands on Uber's cash, the largest of which is defending its market share against other incumbents. Even outside China, Didi has become a formidable enemy for Uber by forming an alliance with several competitors, including Lyft in the US, Ola in India and Grab in Southeast Asia. Didi has encouraged its Chinese backers such as Alibaba and Tencent to invest in those rivals. The four companies are also linking their apps, so that customers can tap into the others' car networks when travelling.

Uber's profits have not been totally immune to this pincer movement. It has cut prices and become unprofitable in some cities in the US in order to stave off advances from Lyft. "Though we do become profitable from time to time, we have to make conscious decisions, even in mature markets, to go unprofitable to protect market share," says one Uber executive. He says the subsidy competition would "just end if this irrational funding would stop at some point", referring to fundraising by global ride-sharing groups. When companies are losing money on every trip, "it really reminds me of 1999, or the tech bubble", he adds.

Uber's biggest problem in China has turned out to be not that it is a foreign company, but that it has finally met a counterpart every bit as disruptive and aggressive as itself. "For Uber, the biggest risk is from a competitive market, not from the government," says iMedia's Zhang.

Given Uber’s deep reserves of cash, it can afford to keep investing. And as a private company, it won’t come under pressure from shareholders demanding profits. Kalanick has said that Uber will go public “as late as humanly possible”, giving a range of one to 10 years – ample time to keep pouring money into loss-making operations. But is there a point at which it would draw a line in China? Kalanick says there’s not a specific number in terms of how much he is willing to invest. “The most important limit is the return on investment,” he muses. “What is your business worth? You certainly don’t want to spend more than it is worth.”

With no net revenues and no profits, Uber China’s worth is hard to assess. As number two in the market, it will always have a somewhat precarious position. Several top Uber China executives say that the company does not need majority market share in China in order to have a sustainable, profitable business. Kalanick, however, defines success in China as being number one – and he doesn’t give up easily. “We like those problems that are hard, those are the ones that excite us most,” he says. “Those are the ones that give us that little glimmer in the eye and get us up in the morning.”

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