ESG *in Depth*

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Workers, Platforms and the Growing Scrutiny of the Gig Economy

- **Problem:** On-demand labor platforms offer new job opportunities for workers and convenient, more affordable services for consumers. However, the independent contractor employment model used by most of these platforms has led to the creation of many low-quality jobs. Given rising income inequality and an increasing share of temporary and contract workers in developed markets, companies relying on a gig workforce face substantial regulatory risk.
- **Development:** Few gig workers who use platforms such as Uber, Lyft, and DoorDash earn a living wage, and most do not gain the flexibility that the independent contractor model is supposed to offer. As a result, many European countries have classified gig workers as employees, and there are signs of increasing societal concern and regulation in other markets.
- **Materiality:** Platforms use the independent contractor model to keep labor costs low and variable. Regulation that either designates contractors as full-time employees or requires platforms to add fixed benefits for workers could lower platform margins.
- **Investment implications and next steps:** Investors should evaluate the margin sustainability of platforms that generate value solely by bidding down the marginal cost of commoditized labor to the lowest price. They should also use our framework to question management or initiate a formal engagement with these companies.

Problem

It is true that labor platforms facilitate trusted digital transactions between strangers — economically and at scale —which creates value for various stakeholders:

Workers: The platforms enable workers to find new jobs, utilize excess capacity (*e.g.*, time and assets) and allow workers greater flexibility and control over their time.

Consumers: Consumers often benefit from lower prices, increased convenience and choice, and fewer asset ownership needs (*e.g.*, cars).

Government: The government benefits from higher employment, the resulting tax revenues and a smaller informal economy.[1]

However, given the lack of pricing power for discretionary services like ride sharing and food delivery, platforms are not incentivized to compensate drivers fairly, leading to very low average hourly earnings and few benefits offered to drivers. Low pay and poor benefits often force drivers to work excessive hours, negating one of the gig economy's purported benefits, namely, flexibility.

The risk of a regulatory response related to these concerns is increased by society's growing focus on income and wealth inequality. Various data sets suggest many developed markets have experienced an increase in income inequality over the past few decades. This is due to many factors, including the decline of labor unions and greater focus on corporate profitability, which have contributed to an increase in temporary and contract work. Temporary and contract work tends to be lower-quality jobs with fewer benefits, further increasing income volatility for workers. The gig economy is an outgrowth of this trend, and the generally poor treatment of workers by platforms is leading to the additional scrutiny of temporary and contract employment.

Development

The two biggest problems with the way platforms treat labor are 1) workers cannot earn a living wage and 2) platforms exert excessive control over workers.

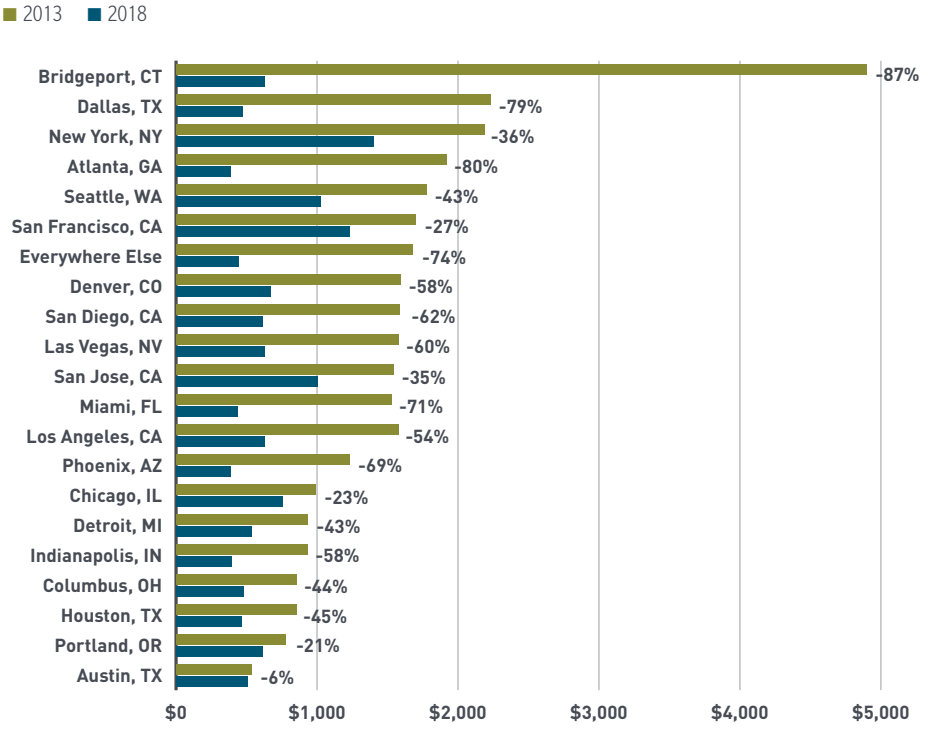
Living wage: While many platforms claim to pay workers a minimum wage, they do not pay them a living or a fair wage. A living wage is one that ensures minimum acceptable living standards, sufficient to cover the cost of necessities such as health care. A fair wage takes this premise further by requiring that wages and benefits are paid regularly and on time, ensuring excessive hours are not necessary to earn a living wage, etc.

Exhibit 1

Because platforms do not disclose wage data — or any data for that matter — it is very difficult to evaluate how they are paying workers.

However, a study conducted by the JPMorgan Chase Institute, which evaluated trends in the online platform economy across 27 US metro areas, showed a 40% or greater decline in monthly driver revenues between 2013 and 2018 in a majority of the areas surveyed.[2] We believe this points to an excess supply of drivers and a reduction in driver incentives, which would lower driver earnings sharply.

Exhibit 2: Change in average monthly revenues on transportation platforms from Jan–Oct 2013 to Jan–Oct 2018



Source: *The Online Platform Economy in 27 Metro Areas: The experience of drivers and lessors*, JPMorgan Chase Institute, 2019.

While most workers do not rely solely on gig work, 20% to 30% do.[3] These workers are at greater risk of exploitation by platforms given information asymmetry and the likely cyclicality of wages based on macroeconomic activity. Should the economy enter a recession, this pool of "precarious" labor is likely to expand materially, attracting regulatory attention.

Excessive market power and influence: Platforms are the only stakeholders with complete control over the data generated by workers and users. Allegedly, some have engaged in unethical behavior such as using data to manipulate consumer or worker behavior. For example, some platforms have been accused of removing pricing information from heat maps to lure workers to accept jobs that may be undesirable.[4]

Given these two concerns, we created a framework to evaluate both labor earnings and platform influence and control. Key questions include the following:

- Are pay algorithms fair, and does platform pass on 100% of tips to workers?
- Is the ratings process fair or are workers unfairly penalized?
- Do platforms provide fair and effective accident insurance?
- Can workers earn a living wage while retaining flexibility?

Although these types of companies are not incentivized to pay labor well, their behaviors vary widely:

Co	Region	Segment	Score	Comments
A	US	Courier	-15	Drivers penalized despite unreasonably short delivery windows. Low tip pass-through. Bad culture.
B	US	Courier	-13	Insufficient earnings opportunity, excessive reliance on low tips. Ineffective live help.
C	US	Food Delivery	-8	Drivers not paid for long waits; hurdles for minimum $/hr too high. No insurance.
D	US	Food Delivery	-5	Unclear if drivers receive full tip. Benefits weak, especially insurance. Review system unfair.
E	US	Ride Share	-4	To earn a living wage drivers have to drive 9–12 hrs/day, reducing flexibility. Weak benefits.
F	US	Ride Share	-1	To earn a living wage drivers have to drive 9–12 hrs/day, reducing flexibility. Benefits improving.
G	US	Food Delivery	0	Can earn a living wage with sufficient bonus/incentives (sustainable?).
H	UK	Food Delivery	3	No penalties for drivers, tips earned in cash and a fair pay algorithm but very few benefits provided.
I	UK	Food Delivery	10	Fair pay algorithm, enough work for drivers, good benefits & review system — but these are recent improvements!
J	Europe	Food Delivery	12	Employees covered by contract through temp agency; no penalties, good benefits. Health & safety training.

Source: MFS original research. The scoring methodology for this framework is based on three categories, each of which includes various sub-themes, that MFS evaluates for each company. The three categories are: fair Pay (*e.g.*, speed of driver access to cash flow from their work), driver benefits (*e.g.*, insurance), and driver support (*e.g.*, driver grievance processes).

Materiality

While platforms argue that consolidation could help resolve both high cash burn from incentives and low worker earnings, there are several counters to this argument.

First, platforms propose to increase worker revenue by acquiring new consumers through consolidation, thereby increasing the number of trips per driver.[5] They do also aim to increase driver revenue by consolidating different types of delivery, (*e.g.*, transporting passengers) as well as food. However, as platforms continue to cut incentives, these solutions would likely require drivers to work more hours and make more drops to earn the same wage and could result in continued driver turnover.

Second, collective bargaining is not effective in the gig economy model because the market is too fragmented. Gig economy companies are lobbying to prevent workers from unionizing, and the ever expanding size of the workforce, along with driver fragmentation, has rendered strikes ineffective.[6] Lawsuits have not resulted in sustained improvements for workers given the massive power imbalance between companies and workers. As a result, it is likely that companies would retain most of the benefits of consolidation.

As a result, there is a growing need for regulation. Even the United States and the United Kingdom — the least-regulated developed markets in terms of labor — are beginning to show signs of change. Several states in the US are piloting regulations that protect independent workers, requiring portable benefits, minimum wages, IRA plans and paid leave for gig workers. Some states, including California, are considering reclassifying independent contractors as employees.[7] This kind of regulation is likely to create financially material impacts on platform company margins over the intermediate and long term.

Next steps

We suggest that investors carefully evaluate the margin sustainability of platforms that, as described above, generate value solely by bidding down the marginal cost of commoditized labor to the lowest price. Platforms that improve worker treatment proactively while monetizing other parts of the business instead are likely to be more sustainable. Investors should also use the company comparison framework to initiate a formal engagement with management teams.

Endnotes

[1] Work that is neither reported to a government nor taxed. The informal economy decreases tax revenues and provides no regulatory oversight or employee protections.

[2] Farrell, Diana, Fiona Greig, and Amar Hamoudi. "The Online Platform Economy in 27 Metro Areas: The experience of drivers and lessors" JPMorgan Chase Institute, 2019.

[3] Source: https://www.mckinsey.com/featured-insights/employment-and-growth/independent-work-choice-necessity-and-the-gig-economy.

[4] Source: https://columbialawreview.org/content/the-taking-economy-uber-information-and-power.

[5] Source: MFS original research.

[6] Source: https://www.vox.com/2019/7/1/20677095/uber-lyft-labor-unions-ab5-california.

[7] Since the internal distribution of this research at MFS, Assembly Bill 5 was passed in California and took effect January 1, 2020. The law redefines workers as employees if their job is part of a company's core business, or if they meet a variety of other criteria.

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