Revisiting the Gig Economy Amid the COVID-19 Pandemic

27 March 2020

Subsequent to the publication of our paper: *Understanding the Investment Implications of the Gig Economy*, a global public health emergency has unfolded. To tackle the outbreak of the coronavirus disease (COVID-19), a concerted effort is required from all parts of society, including individuals, communities, corporates in the public and private sectors, as well as regional and national governments and banks. Sharing the economic burden between companies, workers, and governments will be key to navigating this crisis.

As part of this, companies are having to make very important decisions about how to manage human capital through this pandemic, including how to deliver on their responsibilities to their employees and customers, as well as their shareholders. Many gig economy businesses have proven to be valuable network enablers at this time, ferrying food around locked-down areas and responding to exceptional levels of demand. However, the pandemic is also acutely highlighting the precarious nature of the gig economy worker-company relationship.

Contractually, most gig economy workers that fall ill, or need to isolate, will lose their income. Additionally, governments around the world have struggled to create a safety net of the same strength for this cohort of the workforce as that being provided to people in traditional employment models. This dual insecurity has likely led gig economy workers to continue working, even when they perhaps should not, as the alternative risks substantial shortfalls in income.

Some companies are acting to protect their gig economy workers, with several of the larger platforms committing to hardship funds, which will pay couriers for periods when they are unable to work due to COVID-19. In the short term, this is a win-win. Consumers feel more secure that the couriers with which they interact are more likely to be healthy, and the couriers themselves (who are working in particularly demanding situations) receive some of the benefits that have historically only accrued to employees.

It is too early to tell if hardship funds will become more normalised, and as such soften the differences between gig economy models and full-time employment models. Nonetheless, it seems likely to us that many of the businesses that have traditionally used gig-economy employment models will see an improved revenue trajectory as the pandemic accelerates a shift in society's behaviour towards online and on-demand services. As such, we expect an increasing proportion of the workforce could potentially become exposed to the social and economic trade-offs created by less traditional employment models.

For us as investors, it is important that we understand the impact that different labour practices have on business models and employees when assessing the long-term sustainability of enterprises, while also engaging with companies on social practices, where justified, to help effect meaningful positive change. At Lazard Asset Management, we have developed a proprietary approach to assess the long-term sustainability of enterprises across the dimensions of financial, human, and natural capital. This assessment is applied to both an enterprise's products/services as well as its operations. As part of this, our sustainability scorecard evaluates a company's relationship with various material stakeholders including its customers, employees, suppliers, and the communities in which it operates.

For deeper analysis on the trade-offs faced by workers in less traditional areas of employment, the business models of the companies that employ gig workers, and the geographical nuances of both, please read the following paper.

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Understanding the Investment Implications of the Gig Economy

William Gore-Randall, Senior Vice President, Research Analyst

Rapid advancements in technology have disrupted a number of industries as well as the employment landscape through the rise of the so-called "gig economy"—which pays workers on a "per-job" basis without guaranteeing hours. A number of app-based driver, delivery, and courier service companies including Lyft, Uber, and Deliveroo, have quickly scaled up their businesses by operating in this way.

However, this form of flexible working has started to draw increased regulatory scrutiny in some countries, and in others, regulators have started to force their transition to a less profitable minimum wage structure, eroding the competitive advantages of companies that have built their operations around these relatively new employment models. Longer term, we question the sustainability of this mode of labour relations where it is simply about regulatory arbitrage of employment rights. We believe that in order for investors to fully assess an "on-demand" company's exposure to this risk, a thorough understanding of its employment practices is required.

Why Is On-Demand Work Growing?

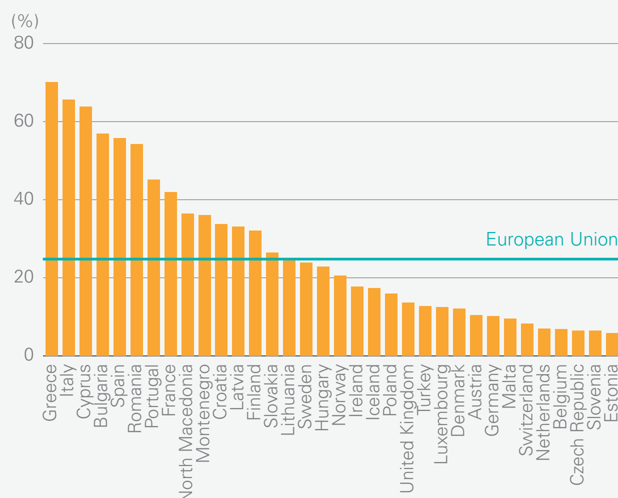
The rise of global e-commerce and app-based businesses, falling levels of unionisation, and a new generation of workers with fresh attitudes to what employment means have contributed to the growth of the gig economy globally. To put this in context, while full-time employment remains the most prevalent model in the European Union, the share of this type of employment has fallen from 62% to 59% in just over a decade, in favour of more flexible employment arrangements, including zero-hours contracts and agency work[1]. Meanwhile, marginal part-time workers—those that work fewer than 20 hours per week—comprise approximately 9%[1] of the workforce in Europe, and have accounted for a growing proportion of total employment contracts across most European countries since 2003.

Is the Gig Economy a Fair Model for Workers?

The expansion of the gig economy has resulted in a marked shift in how labour is being priced and has raised questions about the level of social protection that should be offered to workers in these new models. Some argue that the gig economy creates job insecurity, wage uncertainty, underemployment, and diminished social security entitlement (owing to the risk of lower contributions into social security and pension funds). On the other hand, ultra-flexible working arrangements do allow people to supplement their income at times that suit them in a way traditional employment structures are less able to. Nonetheless, it has been reported that approximately 25% of part-time workers in Europe, including those that work fewer than 20 hours per week, do so involuntarily (Exhibit 1).

Exhibit 1
Part-Time Work Is Not Always a Desirable Form of Employment

Involuntary part-time employment as a proportion of total part-time employment



As at 8 August 2019

Chart shows involuntary part-time employment as a percentage of total part-time employment across European countries in 2018. Involuntary part-time workers are part-timers (working fewer than 30-usual hours per week) because they could not find a full-time job. However, the definitions are not harmonised and are based on national definitions.

Source: Eurostat

Differences in Employment Status

Full-time employees: This is a contractual relationship where hours are agreed in advance. Employees have full access to standard employee rights.

Zero-hours contractor: Worker paid by the hour. Employer has discretion over when and where employee works. Worker considered an employee and therefore they accrue pro-rata sick and holiday pay.

Gig economy: Worker often paid on a "bit-part" basis. Company and worker both "opt in". Worker deemed a freelancer and therefore there is no allowance towards sick or holiday pay.

Employment Statistics[2]

Open-ended full-time contracts:	59% of the share of EU employment. Decreasing trend.
Part-time work, involuntary part-time work, marginal part-time work:	7% of EU employment. Involuntary part-time work accounts for around 25% of part-time work, marginal part-time work accounts for 9%. Increasing trend for all types of part-time work
Freelancers, self-employment:	Freelancers account for 10% of employment in the EU. Stable trend.
Fixed-term contracts:	7% of employment in the EU. Stable trend.
Temporary agency work:	1.5% of total employment in the EU.
Zero-hours contracts:	5% of the workforce in the UK

Non-standard employment could increase the risk of:

- Low pay and in-work poverty
- Stress and negative health implications
- Lack of social security, career development, and training
- Diminished access to labour rights

Typically, wages paid to on-demand workers exclude the benefits afforded to full-time employees, such as holiday and sick pay, pension contributions, health care insurance, and, in some cases, the national minimum wage, which can lead to a marked pay gap between full-time employees and non-standard workers. If left unchecked, this disparity is capable of widening income inequality over time and add to the growing phenomenon of in-work poverty.

In addition, the intangibles that contribute towards the perception of quality of work—such as a sense of fulfilment, personal development, career prospects, and an environment conducive to mental wellbeing—may also be lacking in non-standard employment. While there are similarities between gig, zero-hours, and freelance employment structures, traditional contractors and freelancers are often compensated for the lack of certain employment benefits through higher direct labour rates.

There are also examples of gig-economy workers being impacted negatively by an oversupply of labour at certain times of the day, which can drive down the hourly rate paid below that of the national minimum wage, especially once all the costs of some forms of work—such as fuel—are taken into account. Even when a gig-economy worker's outlays are relatively low—for instance among bicycle couriers—the risk of the hourly rate falling below the minimum wage remains, and importantly falls on the worker, not the company (Exhibit 2).

Exhibit 2
Breaking Down the Bit-Part Rate, Bit by Bit

	Gig Economy Cycle Courier			UK Minimum Wage
	Scenario 1	Scenario 2	Scenario 3	
Deliveries per hour	2.0x	2.4x	3.0x	N.A.
Pay per delivery	£4.00	£4.00	£4.00	N.A.
Hourly gross salary	**£8.00**	**£9.60**	**£12.00**	**£8.21**
Employer national insurance contribution	**£0.00**	**£0.00**	£0.00	£1.13
Employer pension contribution	£0.00	£0.00	£0.00	£0.25
Total gross income to worker	**£8.00**	**£9.60**	**£12.00**	**£9.59**
Cost of equipment/ insurance	**-£0.37**	**-£0.37**	-£0.37	N.A.
Total pre-tax net income to worker	**£7.63**	**£9.23**	**£11.63**	**£9.59**
Total pre-tax cash income to worker	**£7.63**	**£9.23**	**£11.63**	**£8.21**
Total cost to "Employer"	**£8.00**	**£9.60**	**£12.00**	**£9.59**

For illustrative purposes only.

This is a notional analysis based on interviews conducted by Lazard and prevailing UK tax rates. Based on conversations with various participants in the market, we believe that the average bicycle courier in the United Kingdom manages 2.4 deliveries per hour. Calculations assume that workers earn more than £166 per week and are therefore required to make social security contributions. The difference between net income and cash income are various benefit accruals that employed workers receive, primarily in the form of pension contributions.

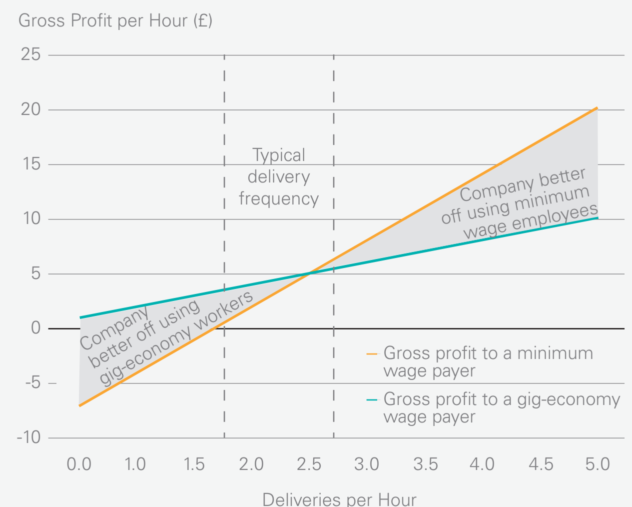
Source: Lazard

Why Do Companies Find Non-Standard Employment Models So Attractive?

Companies that compensate workers according to their output have, on the face of it, stronger business models compared to competitors that pay a set hourly wage, as gig-economy employment models variablise a company's cost base, (i.e., transform fixed costs into variable costs). This creates the potential for an on-demand company to get two bites at the cherry. It is financially motivated to maintain a flexible gig-economy employment structure up to a certain level of output, while also having the option to switch to a full-time employment model at minimum wage, should output pick up enough to justify this increase to the cost base (Exhibit 3). This can help on-demand companies control labour costs, respond quickly to changes in demand, and can offer resilience through different phases of the business cycle relative to companies with more traditional employment structures. Given many gig-economy companies are still scaling fast, and loss making, this resilience is particularly attractive, as without it they find it harder to get funding.

While gig-economy employment models offer a high degree of flexibility and an avenue through which workers effectively price their own labour, the burden of economic risk is passed onto individuals while the lack of job security and protection offered exposes them to being commoditised and viewed merely as part of the platform service's technological infrastructure.

Exhibit 3
How Employers Can Make Gig-Economy Models Work for Them



For illustrative purposes only.

This is a notional analysis based on interviews conducted by Lazard. It assumes £6.00 of revenue per delivery, and either a minimum gross wage of £9.96 per hour or a £4.00 fee per delivery paid to a gig-economy worker. The typical delivery frequency is based on management interviews.

Source: Lazard

How Are Governments Responding?

Growing scrutiny about on-demand working arrangements has forced a number of countries to review their labour laws to ensure that firms that hire people through the gig economy do not bypass their responsibilities and artificially reduce their costs of employment. Governments have started to more clearly define working relationships—what constitutes a worker, an independent contractor, a dependent contractor, a self-employed individual, and an employee, so that gig-economy workers avoid falling into a grey area of employment status that offers none of the benefits of self-employment, but most of the risks of low social protection, including income insecurity. In some cases, this has resulted in gig-economy workers being afforded a basic floor of rights, including guaranteed access to the national minimum wage, holiday pay, and discrimination protection.

The size of the gig economy, the number of people it employs, the average length of employment, the level of pay, and social protections offered are difficult to quantify and track by country owing to the transitory and variable nature of on-demand work and different employment laws by jurisdiction, resulting in a lack of official statistics. Survey data suggests, however, that average working hours across digital platform services stood at 23 hours per week, with the median pay at $6 an hour[2]. Pay levels across the platforms surveyed were significantly lower than national minimum wage rates across European countries. The highest observed gap was 54.1% in France, followed closely by the United Kingdom (46.8%). In Germany, workers were paid on average 29.3% less than the statutory minimum wage. In Spain, the situation with minimum pay standards was considerably better, with the difference at 9.1%, while in the United States, workers had average pay levels that were the closest to the national minimum wage, with a pay gap of just 3.4%[3].

Until recently, disputes have largely been handled on a case-by-case basis at employment tribunals, with a number of legal rulings passed that recognise individuals as workers, rather than being classified as self-employed or independent contractors, therefore entitling them to holiday pay, sick pay, and a minimum wage. However, new legislation is increasingly being passed at the regional or national level. In April, the European Parliament approved new rules to improve workers' protection by granting new rights for individuals on "atypical" contracts and in non-standard jobs, including on-demand gig economy workers. EU member states have, at most, three years to enforce the new rules.

New EU measures seek to ensure more transparent and predictable working conditions, by giving workers the right to:

- Work for other employers by banning exclusivity clauses
- Cost-free mandatory training
- Receive compensation in case of late cancellation of agreed work by the employer
- Refuse, without consequences, an assignment outside predetermined hours
- Pre-defined probationary periods, which is to be limited to six months
- Have information within the first week on the essential aspects of their employment contract, such as:
  - a description of duties
  - a start date
  - duration
  - remuneration
  - standard working day or reference hours

In the United Kingdom, the Taylor Review of modern workplace practices has led to the broadest workplace reforms in more than 20 years. New rules that are due to come into force in 2020 have stopped practices that allowed businesses to pay agency staff less than permanent employees for the same work performed. It also requires businesses to present workers with a statement of their rights on the first day of their employment, including details regarding their eligibility for sick pay and other types of paid leave, such as maternity and paternity leave. Most recently, in the United States, California lawmakers passed landmark employment legislation that could pave the way for the employment status of app-based drivers and couriers to be reclassified from independent contractors to employees.

These developments have put significant pressure on the share price of ride-hailing companies such as Uber and Lyft, both of which have a large exposure to that market. Interestingly, in a bid to stop the law progressing, both companies proposed their own voluntary actions, including a minimum wage of $21 per hour of driving, including expenses, as well as benefits that could include sick and holiday pay. Similar pre-emptive moves have been seen in other markets too, and while on balance it may be more favourable than being subject to legislative action, it still has a material impact on their economic models.

Putting Things in a Global Perspective

It is important to recognise that the growing phenomenon around bit-part employment and the challenges associated with it, are not solely a developed markets concern. Even in markets such as India, where the penetration of gig-economy models is comparatively low, their rapid growth is increasingly bringing the rights of gig-economy workers into focus. Because the base level of employee protections are often lower than those in developed markets, some of the practices in these markets can be particularly aggressive. Examples include high costs being pushed onto the workers themselves, or penalties to deter gig-economy workers from withdrawing their services at peak times and for refusing work, even if they are fully booked with other deliveries. There are examples of things coming to a head and leading to strikes and threats of legal action disrupting services for days in some cities.

Nonetheless, as with many employment topics (e.g, "fair" labour rates) it is important to consider gig-economy practices in their

local context. There are certainly absolutes, such as workplace safety, but when it comes to the trade-offs associated with the certainty of labour, in their local context gig-economy businesses often offer labour opportunities which can be relatively attractive versus the alternatives, which might be totally informal. At the moment most gig-economy businesses that operate in emerging markets are in private hands, however, as they scale up they may seek to go public, making understanding the local context increasingly important.

Understanding the Investment Challenges

The risks around labour practices, especially in relation to the gig economy, are both geographically specific, and fast evolving. Compensation models are often complex, incentive-based, and subject to revisions without notice. In addition, labour is inevitably one of the largest costs for delivery and distribution companies, making their business models particularly sensitive to these changes.

The growing number of legal challenges and tighter regulation around on-demand employment at the regional and national level has important implications for employers, workers, and investors. A raft of initial public offerings of app-based driver, delivery, and courier service companies since the start of 2018, including Lyft, Uber, and Meituan Dianping, means public market investors are increasingly exposed to this growing market. Delivery and distribution companies that are ahead of and resilient to changing regulation are likely to be more attractive relative to those that are not, over the longer term.

A key part of our investment process is to understand the long-term sustainable earnings potential of businesses. Since one of the major costs for many of these delivery and distribution businesses is labour—and as a result it can also be a great competitive advantage if lowered—we make it a key part of our investment process to understand the labour practices being employed, and how those labour practices fit within their geographical context. In our view, any business that is arbitraging the cost of local labour—and by doing so, effectively employing people at below the minimum wage—is unlikely to be able to do so sustainably.

Through regular and detailed engagement with companies, we look to properly evaluate the impact of labour practices and understand them within a global context in order to assess the risks being created, while also engaging with companies on social practices to help effect meaningful positive change. When we meet with delivery and distribution companies, we make a particular point of asking about the unit economics of using full-time employees compared to gig-economy workers, as well as understanding the regulatory background of both in the geographies in which they operate. In all cases, we seek to properly value companies based on the sustainability of their business models, monitoring changes in employment practices and labour regulations.

Notes

1 As at 31 July 2016. Refers to the period between 2003 and 2016. Source: European Parliament

2 Source European Parliament

3 As at 31 July 2016. Source: European Parliament

Important Information

Originally published on 25 September 2019. Revised and republished on 30 March 2020.

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