About Peter Backman

Peter is an expert and commentator on the structure and dynamics of the foodservice sector and its supply chain, in the UK and internationally. Over the last four years, he has made a speciality of analysing the restaurant delivery market. He enlightens senior executives and other people who make significant decisions in the foodservice sector including investors, operators and suppliers to the sector. His forthright and challenging views are based on data-driven insights – as a former scientist his view is "if you can't measure it, it doesn't exist".

He has been involved, as a researcher and consultant within the sector, for over 30 years blending his knowledge with a deep understanding of the trends, key players and challenges of organisations with an interest in foodservice. He regularly speaks at conferences worldwide and his views are sought by television, radio, and the national and trade press. Peter has many innovations to his credit having been the first person to define the structure of the eating out market in the terms which are now widely used by the industry, as well as building the most extensive database model of the foodservice sector. Peter is the author of "Restaurants also sell food" – published in London, Toronto and Chicago.

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Published Autumn 2021

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HOW TO MAKE MONEY FROM RESTAURANT DELIVERY

Peter Backman.

There are many stakeholders in restaurant delivery. In this paper I shall concentrate on two: companies that aggregate orders and deliver the meal and the companies that prepare the meal, which are primarily, restaurants.

As for the other stakeholders – customers, riders, landlords, investors – I shall comment on them insofar as they have an impact on, or are impacted by, developments in delivery.

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WHAT WOULD HAPPEN IF ...?

My analysis shows that restaurant delivery was worth £11.6 billion in the UK in 2020 year and is on track to be worth £14.2 billion in 2021. But nobody is making any money out of it. So why should they bother with delivery?

What would happen if the delivery companies took heed of this and what would happen if they crept away into the night? What would be left?

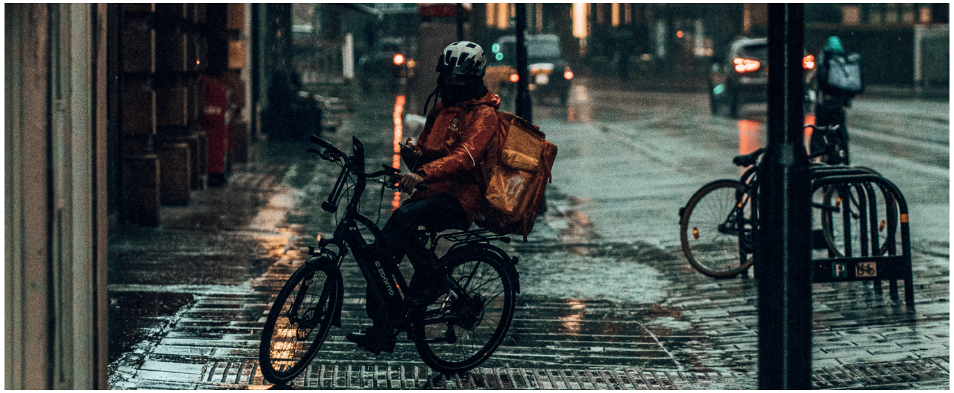
There would be some very disappointed restaurant owners who had built a profitable business on delivery. They would be in the minority though. There would be others who were grateful that someone had taken the decision, to not offer delivery, away for them. And the rest would just shrug their shoulders saying, "Well that was fun while it lasted", and get on with life.

There would be tens of thousands of riders – gig economy workers in the main – who would find their normal source of income (or a part of it) closed forever. But at least in the current frenetic marketplace for workers they would surely find other jobs – perhaps even jobs in the restaurant sector.

There would be piles of unused packaging – plastic containers, aluminium, card, and brown paper bags with no meals to put in them. Behind the scenes there would be unused algorithms and acres of code (and lots of coders) that would be repurposed for the next digital world beater. There would be bicycles, mopeds, and backpacks lying around. There would be empty backstreet premises, and empty small scale business premises on small industrial estates, that used to be dark kitchens. ►

There would be lots of unhappy investors – crowd funders, angel investors, private equity investors, - who had hoped to be able to sell their stake in a delivery business to the next hopeful investor. They wouldn't be able to do that now. There would be a disappointed band of property companies who currently see dark kitchens as an extremely fruitful source of rental income

But above all there would be millions of disappointed people – hundreds of millions, if not billions, around the world. They would find they are unable to order up a meal at a few minutes' notice. And they, and their huge demand (I almost said appetite) for delivery are the reason why delivery will continue – and why delivery practitioners will not creep away into the night even though they need to find ways to address the problem of low or no profitability.



THE FINANCIAL PROBLEM

There are two components to the financial problem that afflicts restaurant delivery.

First, restaurants typically operate a high net margin / low gross profit model.

Second, there are three stages in the restaurant value chain: marketing, back of house, front of house – these can also be talked about as: customer capture, food production, food serving.

There are other problems associated with delivery; high commission rates, restaurants being denied information about their customers, employment of low paid riders, uncertain quality of the delivered meal and many more. But these are a function of how delivery aggregators chose to structure their models and are not inherent in the delivery process per se.

The traditional restaurant model is a **low gross profit model**. It should be noted that some restaurants can be more profitable than others; this arises, for example from the balance between cost of goods and sales price. An example:

- Pizza has low cost input (its components are cheap, and it is easy to prepare) and a reasonable selling price
- Hamburgers have a relatively high cost of goods (meat is expensive) and a modest selling price, at least in the mainstream, mass market).

THE RESTAURANT VALUE CHAIN

Customer capture / Marketing

Food production / Back of House

Food serving / Front of House

Some parts of the **Restaurant Value Chain** can be considered profitable; for example, food bought for the kitchen has a cost and also has income in the form of the money paid by the customer for that prepared food. Typical profitability is about 300%.

But other parts of the chain are inherently unprofitable – taking the plate from the kitchen to the table for example – which has no income ascribed to it. But the cost of the wait staff, in this example, are incurred because there is no other way. The traditional restaurant model works by allocating a single source of income – the money paid by the customer – across each part of the value chain.

In the traditional restaurant these three stages form an integrated whole. Crucially for my argument, this means that costs incurred in one part of the chain are (or can be) recovered in, or at least applied to, another part of the chain.

Restaurant delivery distorts this and walls off each part of the chain, with the consequence that costs are kept within their own part of the chain and, in order to achieve profitability, they have to be covered by income from within that part of the chain.

Delivery inserts itself into this low profit model – notably in the first and last components of the Restaurant Value Chain – Order Capture and Food Serving (or Delivery). And in doing so, Delivery introduces another party with profit needs that have to be satisfied from within this pool of already low gross profits.

The nub is a two-fold problem concerning profitability in the restaurant delivery sphere:

- Walled-off elements in the value chain restrict the allocation of cost to the specific element of income where they are incurred.
- The introduction of another party into the former single-party profit matrix requires, already low levels, of profit to be allocated to more than one party.

This lays the ground for tension and ultimately a difficult (I am tempted to say, fruitless) search for profitability.

What can be done about it?

The solution is one – or both – of:

- Be intelligent, spend less
- Be intelligent, earn more

Workable solutions are different for the two parties in this great game of delivery – operators and aggregators.

But first there is a radical alternative for operators: don't do delivery

DON'T DO DELIVERY?

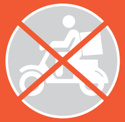
An individual restaurant (or chain) can decide not to do delivery because of the problems it brings with it.

However, customer demand has shown itself to be strong and growing.

THERE ARE ARGUMENTS FOR, AND AGAINST, DELIVERY:

Reasons **for doing** delivery

- Customer demand
- Additional income stream
- Relevant for a "modern" brand
- Developing an otherwise unprofitable region / locality



Reasons **for not doing** delivery

- Unprofitable
- Profit is not worth the negatives
- Disruption in the kitchen
- Prioritises online orders versus in-store diners
- Unsuitable product
- Negative impact on customer perceptions ("the man on a bike with a bag")

If an individual business seeks not to do delivery, it will lose business. For some this will be defensible. For example, the problems may outweigh the benefits either as a P&L issue or as a management issue (concerning, for example, capex requirements, profitability, or operational flexibility). For others, there may be difficulties that are too difficult or expensive to overcome. For example, the product may not "deliver" well.

But, right now, most restaurants (and associated businesses such as pubs) have decided that meal delivery has to be indulged in. In the UK, according to the Takealytics Platform Share Report (April 2021) the top three aggregators – Just Eat, Deliveroo, UberEats – offer their service to a combined 85,000 outlets (out of potential 105,000). So, 80% of outlets consider delivery worthwhile – despite its problems.

A minority (20%?) of operators conclude that the reasons against delivery overcome the reasons in favour of delivery. And so they don't do it. As restaurant dine-in business grows, more restaurants will be asking whether delivery is a sensible option.

SOLUTIONS TO THE PROFITABILITY PROBLEM:

Don't spend money correcting misdeliveries

- The wrong meal was delivered
- The right meal was delivered to the wrong address
- Something was missing from the order
- The order was (very) late
- Something else upset the customer

The default solution: pay the customer – give some or all of the money back, or provide a discount on next meal.

But the most sensible solution is to pay attention to detail and take care of every order just as if the delivered meal was served to the customer in the restaurant.

Stop spending money on attracting customers; Spend money more wisely

Right now there's a battle for market dominance. Spend money to gain customers, then their orders, then their loyalty. But when it comes to delivery, customers are not loyal – or put it another way, they like choice.

They perhaps settle down into a pattern of meals at home, Monday pizza, Tuesday burgers and so on.

But they are also more promiscuous than this, and they are likely to exercise more choice when it comes to eating out. Which pattern will prevail in delivery?

If the eating out model wins, then customers will order from multiple outlets – but buying online is simplified by using a single app (or portal). So the aggregators are engaged in a struggle to gain loyalty to their apps. But it's expensive to gain customers' use of a specific app. Aggregators hope that in the end, they will gain the dominant hand and the competition will melt away.

When that day arrives, the dominant app need no longer spend large budgets for loyalty; the cost of gaining customer loyalty will be removed from the dominant aggregator's P&L, and the business becomes profitable. Voila!

Except that a) there may never be a dominant app but a number of

suboptimal, non-profitable apps as now and b) even if a dominant app emerges, marketing will be an ever-present cost to be deployed against emerging upstarts, alternative ways that customers find for buying food and competitive ways for customers to spend their money other than on food.

Increase the size of the order

Capturing customers is difficult – and expensive. Once you have captured them, getting them to spend more is easier and cheaper.

One way to get customers to spend more is to get them to pay more for the items they were going to buy anyway. For example:

- Increase the price of the menu item compared with the bricks and mortar offer
- Only include higher priced alternatives
- Create higher priced options solely for the app – sharing dishes, meal combos

Another way is for the aggregator to engineer the way that its app works to provide opportunities that allow the operator to:

- Upsell – buy a side dish, add a drink, add dessert
- Charge for delivery
- Develop a "premium persona" on the app

Aggregators can increase their average order size (without requiring their operator partners to charge more). They can:

- Work with higher priced restaurants on their app

Open a dark kitchen

A dark kitchen is a restaurant without a front of house, without tables and chairs and without waiting staff. It is ostensibly a hospitality business but without the hospitality. Merriam Webster defines Hospitality as "the activity or business of providing services to guests in hotels, restaurants, bars, etc." – but notably, this definition does not mention "at home", nor does it define "service".

But on the other hand, and crucially, a dark kitchen has no rent to pay on front of house space – because it has none, and the rent it does pay is lower than for a customer-facing site. Instead, what is essential for a dark kitchen are: orders, a means of meal preparation and a means of delivery.

It is set up to provide a meal with lower fixed costs than a restaurant. And hence, the possibility of offering a profitable delivery option.

Profitability depends on the number of orders and their value. This is the realm of aggregators. And profitability depends on the deliverer; this applies insofar ▶

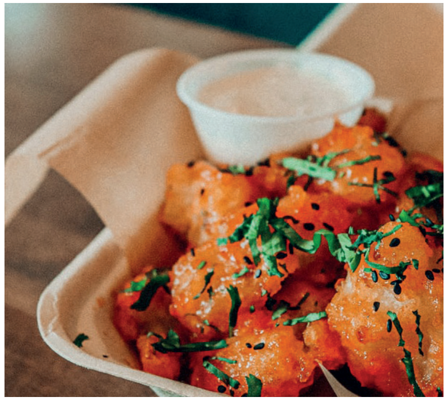
as profitability totally relies on the customer paying, which in turn means the customer must receive the meal that has been ordered (which is achieved by the deliverer).

At a prime level, dark kitchens rely on aggregator deliverers; although there are a number of different dark kitchen models, they all rely on businesses that gain orders, prep the meal, and deliver it to customers.

But this operation needs to be paid for. And the several parties involved – the aggregator, the person or business prepping the meal, the deliverer, the landlord, the manager of the dark kitchen - will all demand their share of the purchase price. And it is not a foregone conclusion yet that this can be done profitably for any business involved in this chain over the long term.

This picture is further darkened by the inefficiencies involved in operating a dark kitchen, notably the high rate of churn of brands and businesses that prepare the food.

But seen through the lens of property owners, dark kitchens are just another property sector to invest in. The investment (in kitchen capex) and levels of default (through operator failures) may be higher than average but should still be manageable and acceptable to the property owner.



So: dark kitchens, by removing some costs, paying less rent, and focusing on just preparing food, provide a seeming solution to the low or no profit problem.

Create a virtual brand

A virtual brand isn't virtual once the meal arrives at its destination. At that point, the customer starts to appreciate the brand – and although this isn't quite true (and I'll cover why shortly), the customer has no prior relationship with the brand other than seeing some images and experiencing some prices and promises of quality and experience. The brand at that point is virtual, and until the customer buys, it has no commercial relevance.

Therefore, the virtual brand has to maintain integrity for most of the time and for most consumers (essentially prospective non-customers) based solely on a promise. That, of course, is what a lot of advertising does. The customer will have a perception of the brand before acquiring it for the first time, and that perception might be different from the one gained after experiencing the product. The promise and expectation are what sustains the brand and encourages people to seek out the product and buy it. Once purchased (and consumed or used), the product ceases to be virtual and is judged on things like its quality and its value for money. If it passes the customer's test, and so long as it remains accessible, the customer may well buy again.

Now we come to the crucial thing from the restaurant operator's perspective. The bricks and mortar restaurant operator is experienced in managing and inducing changes between what the customer expects before walking into the restaurant for the first time, and how they feel when they walk out. From the traditional restaurant operator's perspective this difference is the change brought about by a whole series of personal interactions in the restaurant – from the greeting, to taking the order, to serving, to checking that everything is OK, to enquiring if anything else is acquired.

In a virtual brand all of this personal interaction is missing.

So for the restaurant operator that "sells" under a virtual brand there are two things that have to be coped with. The first is the need to use an app to create perceptions of the brand sufficient for the customer to want to buy. The second is the fact that the operator cannot use its strength – hospitality, the personal experience, the immediate reaction to a request – to reinforce, and if necessary change, that perception.

I argue that restaurant operators are not geared up for the first of these – and as for the second, by adopting a virtual brand, the operator has chosen to work with one hand tied, metaphorically, behind its back.

A number of other, sometimes justifiable, complaints are also held against virtual brands: they mislead the customer; they lead to a proliferation of unremembered brands; their costs are thinly spread over many brands; there is much trivial, disruptive competition leading to confused customers.

This then leads to the conclusion that a virtual brand is a different beast from a restaurant brand. And being commercially effective in one is definitely not grounds for believing it will be effective in the other.

CONCLUSIONS: MANY PROBLEMS, MANY SOLUTIONS

Delivery presents one overriding benefit - it's what customers want. Along the way it presents many difficulties and a wide range of solutions.

One key difficulty is profitability both for the restaurant and the aggregator.

But there are ways to move in the direction of profitability, and solutions are to be found in this white paper:

- Radically, don't do delivery
- Don't spend money on misdeliveries – instead, invest in doing things efficiently and correctly in the first place
- Spend money more wisely than indulging in insanely expensive campaigns to attract customers
- Increase the size of the order
- Use a dark kitchen to remove front of house costs
- Create a virtual brand without expensive bricks and mortar infrastructure

There are many choices involved in creating a workable (if not necessarily profitable) business model for delivery. They include:

- **The nature of the kitchen**
- **The nature of the brand**
- **The type of offer**
- **How the front of house operation is configured**
- **How delivery is done**
- **How orders are won and organised**
- **The role, if any, of franchising**

And the core choices that define any delivery model are summarised in this chart:

Kitchen	Bricks & mortar
	Dark kitchen – standalone
	Dark kitchen – piggy back on bricks & mortar kitchen
Brand	Traditional restaurant / bricks & mortar brand
	Single virtual brand
	Multiple virtual brands
Offer	Ready to Eat
	Restaurant meal kit
Front of house	Front of house offer for one brand
	Front of house offer for many brands
	No front of house
Delivery	Does own delivery
	Deliver via aggregator website / app (eg Deliveroo)
	Delivery via third party (eg Stuart)
	Takeaway / Collect / Drive through / Kerbside pickup
	No delivery
Online ordering	Primarily via aggregator / marketplace
	Primarily via own website
	No online order
Franchised	Franchise
	Non-franchise