Hot Topics Briefing: Third Party Deliveries

Foodservice Operators Can Benefit From Retailers’ Experience

On-line ordering apps and third-party delivery companies are changing how a fast-growing segment of customers purchase and consume meals. Savvy operators will benefit by examining the lessons learned by retailers who have had to adapt to business models more suited for capturing multi-channel demand.

The rapid and unrelenting growth of on-line demand over the past decade has presented a generational change for retailers. The challenge has been to adapt highly efficient distribution operations that were previously focused only on replenishing a few store inventories in large quantities a few times a month to include thousands of one- or two-line orders shipped to thousands of locations around the country each day. The retail industry calls this marriage of fulfilling in-store and on-line demand, omni-channel.

After various fits and starts, retailers like Walmart and Home Depot have become quite good at fulfilling on-line orders while maintaining their in-store inventories and shopping experience. Others have failed and fallen by the wayside (Toys-r-Us, JC Penney, Sears, The Limited to name a few).

Obviously, Amazon has been the change driver in the retail world. Similarly, sweeping change has really just begun for restaurant operators in the form of third-party food delivery. Ordering food for delivery is hardly a new idea: kids are having a sleep-over...order a few pizzas; meeting at the office is running longer than expected...call for sandwiches from the nearest deli. The major change is the combination of ordering apps and third-party delivery that has transformed the way we “order out.”

The Question

The growth in customers’ desire to have meals delivered is rapid and real. On-line ordering, which generates over half of all deliveries, is projected to grow from $25 billion (2018) to $68 billion by 2023, even surpassing on-premise sales. The big question: Is this change away from in-restaurant dining a new growth driver for restaurants? Some believe the answer is yes. Outback Steakhouse, Wingstop and Chipotle have each attributed significant sales growth to new delivery options made available by third party partners. Delivery not only creates new orders; it often results in larger orders. For example, Cheesecake Factory has seen an increase in desert orders for delivered meals as compared to those served in-house. Others argue that the growth in on-line ordering and delivery is merely a shift of existing business. Even so, it may signal shifts in market share from restaurants with poor delivery options to restaurants with better ones.
Third-party deliverers are at the heart of this change. The adjacent figure shows market shares for the major firms. Grubhub was the big fish until recently; today DoorDash leads in US sales. Uber Eats has generated a lot of buzz but has seen business slow following parent company Uber’s IPO this Spring. Amazon has exited the business entirely.

Each of these companies claims a strong base of business in different major cities (see figure below). Grubhub has strong market share in the major east coast cities, while DoorDash dominates other regions.

Customer purchase behavior does appear to be shifting to greater use of on-line ordering apps and fast, cheap delivery. Restaurants that accept the trend and work to stay on top of shifting customer preferences will ultimately benefit (e.g., survive). At least some of those that fail to recognize and accept the shift will see business shrink.

Two Truisms of the New Restaurant Reality

The first truism is that, for a significant segment of customers, ordering and dining preferences have already changed...and they are unlikely to revert. Restaurant operators should expect to see the same trend that retailers have seen, where today almost 15% of business comes from on-line orders.

The consensus among retail executives is that this figure will continue to grow. In other words, because customer buying preferences have changed, those sales have left the store environment forever.
The on-line/delivery segment has high expectations for quick delivery service with no reduction in quality. Restaurant delivery is growing three times faster than on-premises sales, mirroring the rapid growth seen in the retail sector earlier in the millennium. Interestingly, less than 40% of table service operators and 52% of fast casual restaurants currently offer delivery. Operators that have not added delivery options (a) are missing a growth opportunity, and (b) may be putting the long-term viability of their business at risk.

The second truisim is that cost recovery of delivery service is, and will be, a problem. Retailers have struggled to break even – and most still lose money on shipping because of high transportation costs associated with today’s standard two-day delivery. Amazon’s recent push to make one-day delivery the standard going forward is only making this problem worse.

Delivery adds cost to the order for restaurants, with most third-party services charging a percentage of the total ticket as the delivery fee. In addition, delivered orders may be less profitable, as they often do not include highly profitable items such as drinks. Some restaurants have simply eaten the added costs and lower profit margins. As long as their prices cover variable costs of the orders and in-store sales cover fixed operating costs, then the incremental sales can be seen as profitable. Other operators have raised meal prices or added delivery charges. Interestingly, there is evidence that higher menu prices have not hurt sales.

Looking into the Crystal Ball

If we accept that the sea-change to on-line/delivery is underway, and if the change is in line with what we have witnessed in the retail environment, then restaurants should expect to see 10-20% of their business move “out of the building” in the next few years. How should forward-thinking operators respond? A number of trends may help point the way.

• Call ahead / In-store pickup. Several fast-casual brands including Panera Bread and Chipotle have installed shelves where completed customer orders are placed to be picked up immediately upon customer arrival. This approach is more convenient for customers, and it also eliminates much of the in-store wait for third party delivery drivers, thus increasing the chances that the meal arrives in the customer’s hands while it is still hot/cold/fresh.
• **Delivery-only locations.** Chick-fil-A is piloting catering and delivery only locations in Nashville and Louisville, with the Nashville location also serving walk-up customers for pickup. This strategy is similar to the dark store concept tested by several retailers over the past decade. The format works best in densely populated areas with the potential for many deliveries in a small geography.

• **Ghost kitchens.** The ghost kitchen concept takes delivery-only locations to another level entirely. These kitchens handle delivery business for multiple restaurants concurrently. They are typically located in industrial buildings to minimize rent and utility costs. A handful of key players have emerged in this space. Deliveroo has already opened about 30 shared kitchens in the UK and Europe. Kitchens United expects to have as many as 15 shared kitchens in operation by the end of the year. CloudKitchen, the most secretive of this group, has apparently purchased as many as 10 locations in major US cities. Each of these firms has major financial backing and thus the potential to grow quickly if/when the concept shows success.

• **Technology driven solutions.** No surprise, technology is fueling innovation in the delivery space. If you work in a big city you may soon be seeing autonomous vehicles and robots delivering food. DoorDash is piloting driverless vehicles in San Francisco for delivery of restaurant and grocery orders. Customers will receive a text or call to come to the curb to pick up their order. Postmates is piloting an autonomous robot for delivery in Los Angeles. Similarly, Pizza Hut is testing FedEx’s new Autonomous Delivery Bot, and Dominoes is experimenting with its own robotic unit.

Retailers have learned there is not a one-size-fits-all solution to handling omni-channel business. Today’s best omni-channel retailers are experimenting with multiple strategies and various technology solutions throughout the past decade. Many of these attempts led to dead-ends, but ultimately each successful retailer has found an approach that paid off. Restaurant operators will likely need to pursue similar types of experimentation. They have a lot to learn from their retail counterparts.

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