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## Restaurant Food Delivered: Embracing the 'Disruption'

By [Helene Mills](#)



Welcome to the third Pragma Monthly, a deep dive into the key issues affecting retail, travel and consumer businesses, to accompany our weekly Pragmatists and our quarterly white papers.

In this paper we explore the emergence of delivery-only kitchens, which are set to shake up the restaurant industry. We have spoken with key operators in the sector, to understand their response to shifting consumer behaviour and advances in technology and we weigh up the operational challenges of delivery, and consider what the future holds.

Firstly, the context...

## **Sector Dynamics**

Britain has a wider range of eating-out options than ever before, with the industry facing unprecedented levels of competition, unrelenting price pressures and an evolving market.

Operators are battening down the hatches in what has been described as ‘The perfect storm’ of external pressures: spiralling business rates, labour costs, COGS (cost of goods sold), rising rents and market saturation.

Amidst these challenges, many businesses have been focusing on trimming their estates rather than opening new locations. 2015 saw the peak of the ‘space race’ with a +6.5% increase in outlets, but is set to slow to 3.7% in 2017, continuing the downward trend from 3.9% in 2016.

UK outlet growth is now concentrated around ‘fast-casual’ or ‘grab and go’; Five Guys and Subway continue to appear on high streets. For most, however, the days of cookie-cutter roll-out have passed; and the key to continuing to thrive is focusing on differentiated, consistent product, and reaching customers through a range of channels.

## **The Changing Consumer**

Consumer outlook and behaviour has changed beyond recognition, and several of the characteristics of modern society correlate strongly with delivery service uptake:



The missions, priorities and mindsets are also different. Eating out remains driven by occasion, with quality of food and service, atmosphere, and presentation being top priorities. The customer is buying the experience in its totality. Whereas for delivery, the priorities shift to ease of ordering,

swift arrival, food that travels well and still tastes good, attractive and effective packaging.

## **The Rise of Delivery**

Food delivery is not a new phenomenon. For decades restaurants have been taking orders directly from customers, to prepare and deliver. National branded pizza companies e.g. Domino's, are the best examples of these, as well as independent local operators (Indian, Chinese, pizza etc.). The competitive positioning of such traditional players is coming under increasing pressure as their share of the market is challenged by a plethora of delivery alternatives.

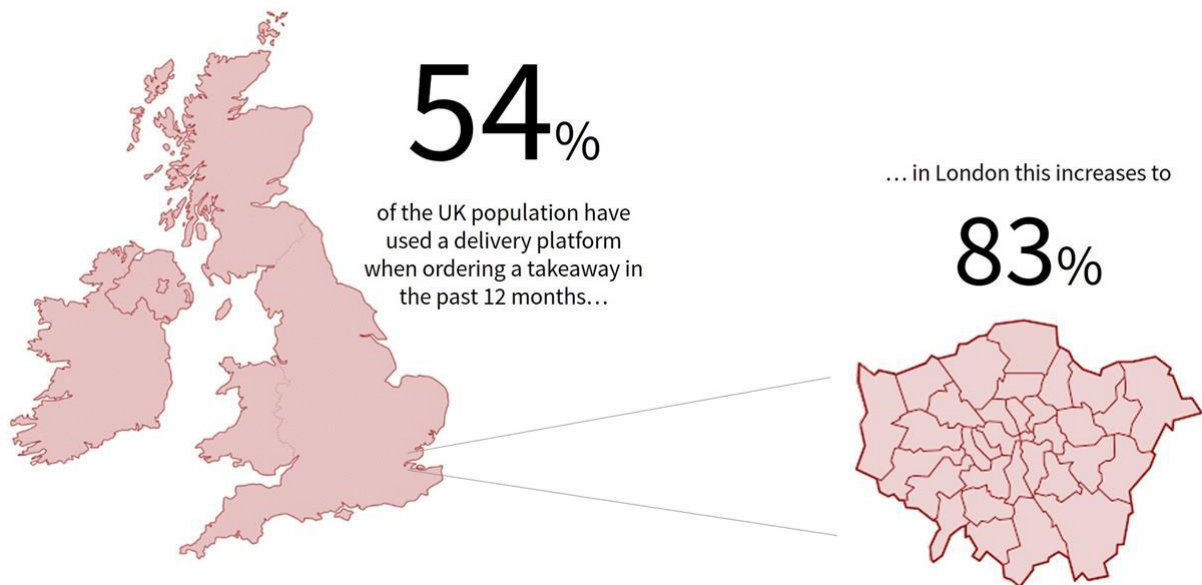
Technology has been the enabler in driving uptake. Delivery has been given a massive digital-reboot via mobile platform technology and digital marketing. Aggregators, like Just Eat, have provided a digital ordering facility to independents and brands who otherwise have a limited online presence, while full service delivery platforms, like Deliveroo and Uber Eats, have opened up new channels and logistics solutions.

The consumer wants choice and convenience - to place an order online or through an app, and to receive a restaurant-quality meal at home.

Comparing foodservice to other consumer sectors, the industry has actually been a late adopter in channel diversification, and simply playing catch-up to meet customer demand.

Delivered food has become an increasingly important part of urban living. According to NPD, demand for home delivery of 'ready-to-eat' food grew ten times faster than for dining out last year. Horizons estimates that the delivery channel was worth £5.9bn in 2016, a 9% increase over 2015 and a 50% increase since 2008.

Uptake has been highest in the capital, but is becoming more widespread across the UK, with over half claiming to have used a delivery platform when ordering in the last 12 months.



From the operator perspective, the emergence of delivery platforms has helped ease softening sales, driving the top line as well as broadening reach.

While the sector is grateful for this, the rise of delivery is reshaping restaurant business models and influencing the underlying economics.

### **The path ahead?**

So, what does it mean for operators in the day-to-day running of their restaurants? And where is the market going next, in terms of people using brands and accessing food?

The sector is responding by following consumer demand ‘indoors’. Operators are starting to think about their channel mix, taking stock of the implications and adaptations required to their models to succeed. Deciding which approaches to integrate into restaurant expansion strategy means weighing up the costs and benefits of click & collect, takeaway, partnering with a delivery aggregator or running a delivery-only kitchen.

Some are positively embracing the delivery channel, while others remain more sceptical about the combination of operational headaches, as well as delivery commissions ‘eating into’ profitability.

### **Delivery headaches**

Partnering for delivery adds a level of operational complexity. Demand peaks for delivery orders and dine in tend to run in parallel, leaving operations stretched. Challenges relate to kitchen capacity and space allocation, team resourcing, packaging, driver access and menus.

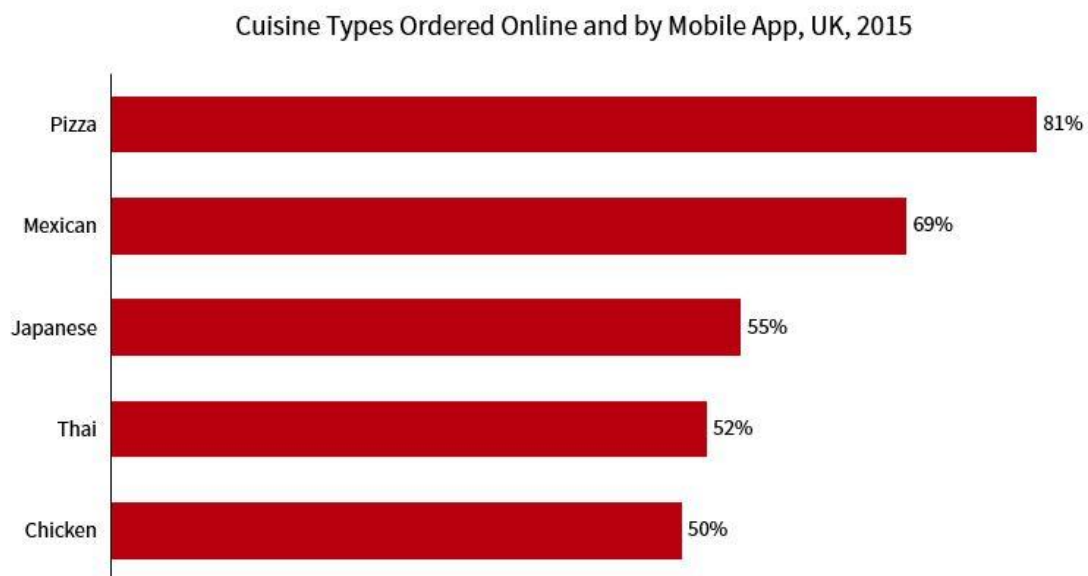
On the shop floor, we see issues with staff distraction, as well as the stream of delivery drivers impacting dine in experience and brand perceptions.

Sites are now being sought with different criteria in mind – rear entrances for easy delivery driver access have become a key property ‘selling point’, and locations with a high residential population hold greater appeal. The focus is shifting towards fit-for-purpose propositions, incorporating delivery.

*“Sites where Deliveroo drivers can come discretely to the back door is key, separating your audiences. When you’re dining in you don’t want someone hitting you with a massive bag.”*

### **Founder, New Entrant Dining Concept**

Certain cuisine types travel better, and this reflects in their uptake:



Source: Liberum, The Times

But whatever the cuisine type, the fact is that most restaurants relinquish control of what happens to their food between leaving the restaurant and

its arrival at the customer's house. If it goes wrong in any way, this reflects badly on the restaurant, which can be very brand damaging.

Restaurateurs are having to reconsider their menu and pricing proposition with delivery in mind, taking into account the need for food that travels well, but more controversially, the balance between portion size and cost, to mitigate the margin impact of the delivery commission.







*“If you’re paying a commission you need to make money somehow, so different prices have to come into play. Then you start thinking about which products you should be selling.”*

### **CEO, Leading Casual Dining Chain**

#### **Commercial Implications**

Delivery commissions of c. 20-25%+VAT of sales order have a direct and significant impact on margin. If you add to this the packaging costs and lower margin sales mix (less wet sales), the overall commercials do not appear very palatable.

***The key things for decision-makers to ask themselves are:***

-  Is my infrastructure fully utilised and running at capacity?
-  How will delivery impact on demand peaks?
-  Are delivery sales incremental, or cannibalising dine in?
-  What do I get in return for my delivery commission?
-  Who will ‘own’ the customer data?
-  For which channels should we be incentivising use?

For those investing in food service businesses, it is reasonable that investors adjust their EBITDA expectations in valuations of businesses with a delivery component.

### **Is delivery optional?**

Despite the prevailing concerns, in a tough and competitive market, delivery presents potential to grow incremental sales through increased brand awareness and reaching a new customer base, while utilising surplus kitchen capacity. While the commercials are no doubt impacted, restaurateurs (like everyone else) bank pounds, *not* margin, and quite simply, these are pounds which will otherwise go elsewhere.

*“We exist to give customers what they want. If customers want to buy our food through UberEATS and Deliveroo, we should do it. At the end of the day, it’s a sale we wouldn’t get. I don’t think customers are choosing between delivery or coming to us. So right now, it’s right to be there.”*

### **Head of Strategy, Coffee and Sandwich Chain**

Delivery is increasingly an expected part of the offer. Operators need to work out how to most appropriately and efficiently bring delivery into their mix, despite the commercial and operational challenges.

For emerging brands, striving to win market share, it will help drive growth through incremental sales and leveraging fixed overheads.

For more established players, the question of cannibalisation is very real, and must be managed through channel and estate optimisation to achieve the best outcome.

### **A clear case for Delivery-only service kitchens**

In the face of growing demand and the operational challenges of servicing delivery from an existing restaurant, the market is opening its mind to the notion of delivery-only kitchens.

*“In the past you couldn’t really take more orders than there were tables, so your kitchen never really had an issue managing that capacity. You designed a kitchen for whatever capacity was needed. But now, there is a massive capacity issue as you may have lots of different channels all*

*pushing orders into locations that are still trying to serve the customer in the restaurant.”*

### **CEO, Casual Dining Chain**

There are several benefits of operating an off-site kitchen dedicated to delivery. The separation of restaurant and delivery means increased coverage and capacity, more affordable pitches, lower fit-out cost, fewer customer-facing staff and a better customer experience through both channels.

ClockJack Chicken is a good example, where the operators moved away from their 50-cover, high rent Soho site, in favour of a restaurant in more affordable Woolwich and a delivery-only basement kitchen in Monument. Collectively this resulted in lower costs and greatly increased capacity to generate sales.

Operationally, running a delivery kitchen is very different from a restaurant operation, and to do it effectively requires the skillset, preparation, adaptation and investment to make it work. PizzaExpress tried but, deterred by the costs and logistics of running their own delivery operation, decided instead to partner with Deliveroo.

### **Deliveroo Editions**

Deliveroo has trialled, and is rolling out, what appears to be a natural solution, and an easy expansion plan in the form of their ‘Editions’ delivery-only kitchens, in which chefs from different restaurants cook exclusively for Deliveroo orders. Foodservice brands effectively buy into the kitchen space, serviced by the delivery fleet. The operator’s only concerns in this arrangement are COGS and staffing.





Deliveroo currently only has a handful of these - with the most recent opening in Hove, and many more planned. The brands which have taken up residence to date include established chains such as Wagamama, Franca Manca, Busaba, MEATliquor, as well as many more local operators with one or two existing sites.

From the customer perspective, the singular focus on delivery means that speed, packaging, etc. is optimised, and it is reasonable to expect that taking the complexity out of the equation results in a better service. And from the operator perspective, the appeal of integrating a delivery only kitchen into their expansion strategy is in driving volumes and serving new areas that they would not otherwise achieve, with less initial capital risk.

On the flip side, this raises the question of the importance of a physical presence as a window to the brand – how easy is it to get traction if people don't see and experience a restaurant?

In our view, the answer lies in data capture and technology.

### **What does the future hold?**

The future will be led by consumer demand, and enabled by technology. Delivery will continue to grow, and 'bricks' restaurants will have to strive to offer differentiated dine in destinations, in line with the rise of the experience economy.

There will be winners and losers. The shifts in the landscape are lowering the barriers to entry, creating easier expansion options for innovative start-ups, and feeding the consumer appetite for newness. The bigger challenge will be faced by the less agile, established mid-market players. Those supporting tired brands across over-extended physical estates need to find commercially effective ways to take a slice of the delivery market, while also striving to draw people through their doors.

There will no doubt be continued growth in delivery-only kitchens. More purpose-built, multi-brand production units, to include versions of the Editions partnership format, as well as operator run kitchens as an economic solution for multi-brand restaurant groups. Longer-term, we anticipate a shift towards multi-cuisine delivery kitchens, such as the [Green Summit](#) concept in the US: one operator, one central kitchen and a portfolio of customer-facing 'own brands'.

The ability to harness digital technology and embrace the benefits of real-time data analysis will be the key weapon in fighting margin erosion and resuming growth; identifying hot-spots for new delivery territories, engaging new customers, and supporting operational efficiency. The customer journey will become more seamless, with one-click purchases. Delivery partners will hone their propositions to focus on data and relationship management, and automation (drones and driverless cars) will reduce labour costs.

The best operators will remain open-minded and embrace change and progress, constantly reassessing operating models to maximise sales and profit to keep pace.



## About the Author

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Helene has over 15 years' experience in strategic consultancy, and has led many projects for clients across diverse sectors, including fashion, leisure and F&B.

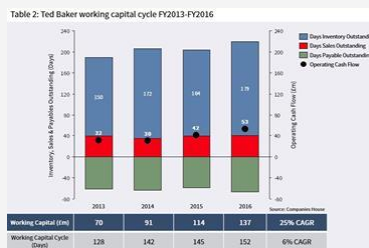
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