Food Delivery App Industry

Winter 2021
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Oregon Consulting Group
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Industry Overview

Industry Characteristics

These third-party apps help restaurants that don't have an established delivery service deliver food to their customers. Recently, COVID-19 has caused a major shift in customer behavior, increasing the demand in this industry.

Industry Statistics

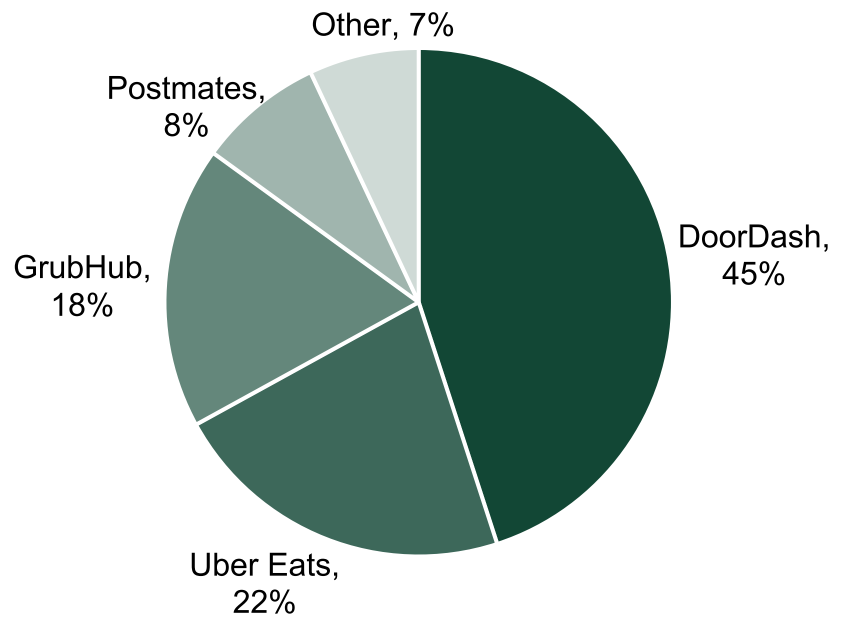
Annual Revenue
$26.5 billion

Online Users
111 million

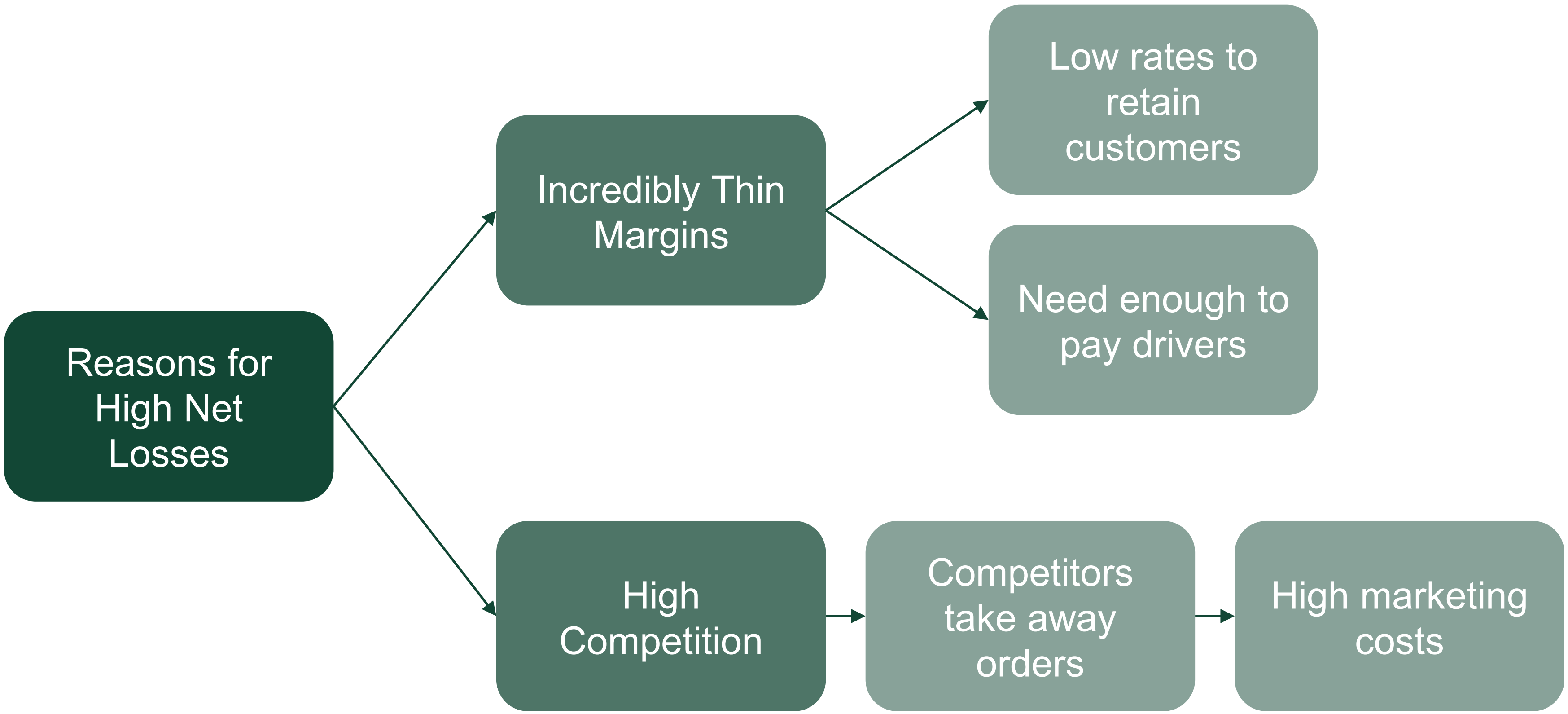
Projected Growth (Pre COVID)
+13%

Projected Growth (Post COVID)
+21%

Market Share Distribution



Problem 1: High Net Losses



By April 2020, food delivery companies had increased their online advertising expense by over 205% compared to their digital spending in January of that same year.

Problem 2: Increased Competition from Restaurants

The restaurant industry has been hit hard due to COVID-19. According to data from Yelp, since March 2020, over 53% of restaurants registered on their platform are now listed as permanent closures.

Why Business are Turning Away from Third-Party Delivery Apps

Commissions

Marketing

Customer Service Control

Ghost Kitchens

Ghost kitchens, also known as virtual or cloud kitchens, are facilities designed solely for delivery orders.

Restaurant Qualities		Ghost Kitchen Qualities		Ghost Kitchen Advantages
Large space for kitchen and dining	→	Small space for kitchen	→	Lower overhead costs
Placed in expensive high foot traffic areas	→	Placed wherever	→	Lower real estate costs
Need to pay for chefs, waiters, and hostesses	→	Only paying for chefs	→	Lower labor costs

Solution

Steps to Address the Issue

- Buy out a warehouse and place multiple mini kitchens inside
- Rent out the spaces to restaurant owners and in return, lower the commission percentages
- Create a new “Ghost Kitchen” subgroup on the app
- Heavily market new delivery option and advertise benefits like faster delivery times

Impact

- Restaurants that have been shut down can use this as an alternative, improving the restaurant industry
- Create a new customer segment of users who prefer the express service
- Increase revenues for third-party apps which can decrease the high net losses

The Future of Food Delivery: A Lose-Lose Situation

Background

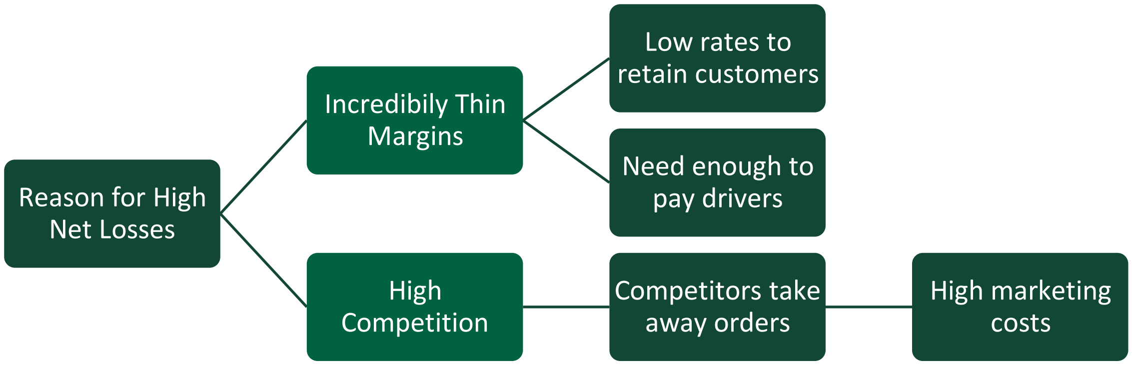
The COVID-19 pandemic caused a massive change in dining behaviors among restaurant-goers in the United States. This resulted in an increasing demand for take-out and online food delivery. The food delivery app industry heavily benefited from this, having gained over a total of 111 million online users, a 16% increase from the previous year (*Food Delivery App Market*, 2020). Market revenue has also increased by 204% in the past five years thanks to more restaurants partnering up with these third-party delivery apps and thus widening the selection of food for their consumers.

Five companies dominate the market, taking up 92% of the total market share. In order of percentage market share, the companies are DoorDash (45%), Uber Eats (22%), GrubHub (18%), and Postmates (8%) (McKinnon, 2020). However, due to high net losses and high market saturation, its flawed system might result in the collapse of this industry.

Current and Future Issues

Profitability

Despite their influx in customers due to the pandemic, these third-party delivery apps are not generating profit. DoorDash, the leading company in this industry, reported a net loss of $667M in 2019 compared to a net loss of $204M in 2018 (*DASH: DoorDash Inc. Cl A Annual Income Statement*, 2020). This industry is constantly operating at a net loss, with their losses increasing every year.



The food delivery companies are put in a tight spot when determining their rates. They need to keep rates relatively low so consumers are still willing to pay the delivery fee while also keeping them high enough for the drivers to be willing to work for the service (McKinnon, 2020). Additionally, the high competition for a seemingly homogenous service forces the firms to advertise heavily to differentiate. By April 2020, food delivery companies had increased their online advertising expense by over 205% compared to their digital spending in January of that same year (Merchan, 2020). This drastic spending increase highlights the companies' need to reach newly stay-at-home online users caused by the pandemic and secure a larger consumer base. Since the firms cannot do much about their rates, food delivery apps need to find ways to cut back on costs that does not hurt their employees or their customers.

Restaurant Retention

Another current issue third party delivery apps are facing is their poor relationships with restaurants. The restaurant industry has been hit hard due to COVID-19. According to Yelp, since March, over 53% of restaurants registered on their platform are now listed as permanent closures (Shapiro & Gole, 2020). Due to consumer fears and government mandates, in-person dining has plummeted and restaurants that are still operating need to turn to delivery to stay afloat. Yet their partnership with food delivery companies is not as profitable as they seem.

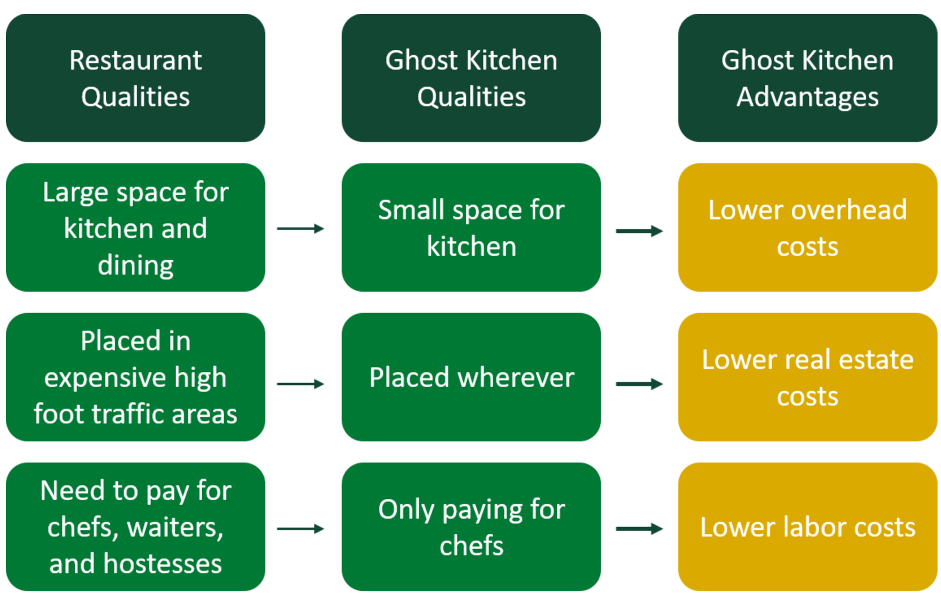
Delivery platforms take a 15%-30% commission on each order (McKinnon, 2020). Paired with the already thin margins of the restaurant industry, owners are concerned about profitability. Restaurants are seeing a direct correlation between the delivery services and the reduction of the restaurant's income (McKinnon, 2020). Most food delivery companies will also charge extra for certain marketing benefits like manipulating ranking in search queries to get noticed by new customers. Information on the effectiveness is difficult to find, but Uber Eats claims to see a return on ad spending of five times, yet further data needs to be collected to solidify that claim (Williams, 2020). However, the rates that food delivery companies are charging for marketing is substantially higher than the typical 3-6 percent of restaurant sales (Batra, 2020). Even though these delivery companies have been a solution during these troubling times, the facts are showing that they are contributors to restaurant failures.

Due to this, restaurants are put in this tight spot. If they partner up with food delivery companies to reign in customers and generate some revenue, they will ultimately suffer a decline in profits. Because of the ill-fated relationship with food delivery companies, restaurants are finding their own methods to capture and deliver to a decent portion of customers during the pandemic. Restaurants are beginning to offer their own delivery services, such as IHOP, KFC, and other various food chains (Sumagaysay, 2020). Bigger restaurant chains are finding that controlling the delivery process allows them to control the customer service experience, retain customer data for future deliveries and promotions, and obtain higher profits (Durbin, 2019). By not having a profitable model for restaurants, food delivery companies are facing greater competition with the restaurants they previously worked with. Not only do food delivery companies need to find ways to cater to their online users, but they must also find a way to create a mutually beneficial partnership with restaurants to avoid further competition.

Possible Solution

Ghost Kitchens

As the meal delivery market grows, businesses are looking for new ways to increase productivity and decrease costs. One possible solution is ghost kitchens. Ghost kitchens, also known as virtual or cloud kitchens, are facilities designed solely for delivery orders. When compared to their restaurant counterparts, ghost kitchens provide certain advantages that can help restaurant owners reduce their costs and therefore increase their profit margins.



Food delivery companies need to start investing in spaces for their restaurants to adopt this ghost kitchen model. What this would look like is the food delivery company would buy out real estate like a warehouse with multiple commercial kitchens for different restaurants to rent out. The restaurants that rent out these spaces would then only have to prepare the food while the orders and delivery are handled by the app. This would especially benefit smaller restaurants during the pandemic so they can raise funds without paying rent for a larger brick-and-motor location. Additionally, having restaurants pay rent would provide the food delivery company with another source of revenue. Certain services have already started to take initiative with this project. At the end of 2019, CloudKitchens, a start-up from Uber's former chief executive, raised $400M to buy cheap real estate and build shared kitchens for restaurants to rent in the United States, China, India, and the UK (Reiley, 2020).

Even before the pandemic hit, industry professionals predicted that ghost kitchens were becoming the future of dining. Especially since COVID-19 shot up ghost kitchen demand in this past year, the food delivery app industry needs to adopt this model if they wish to be successful in the future. There is a learning curve for this new and evolving model. However, this solution can help alleviate the losses experienced by restaurant owners during the pandemic and make third-party delivery apps a more feasible option in the long run.

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