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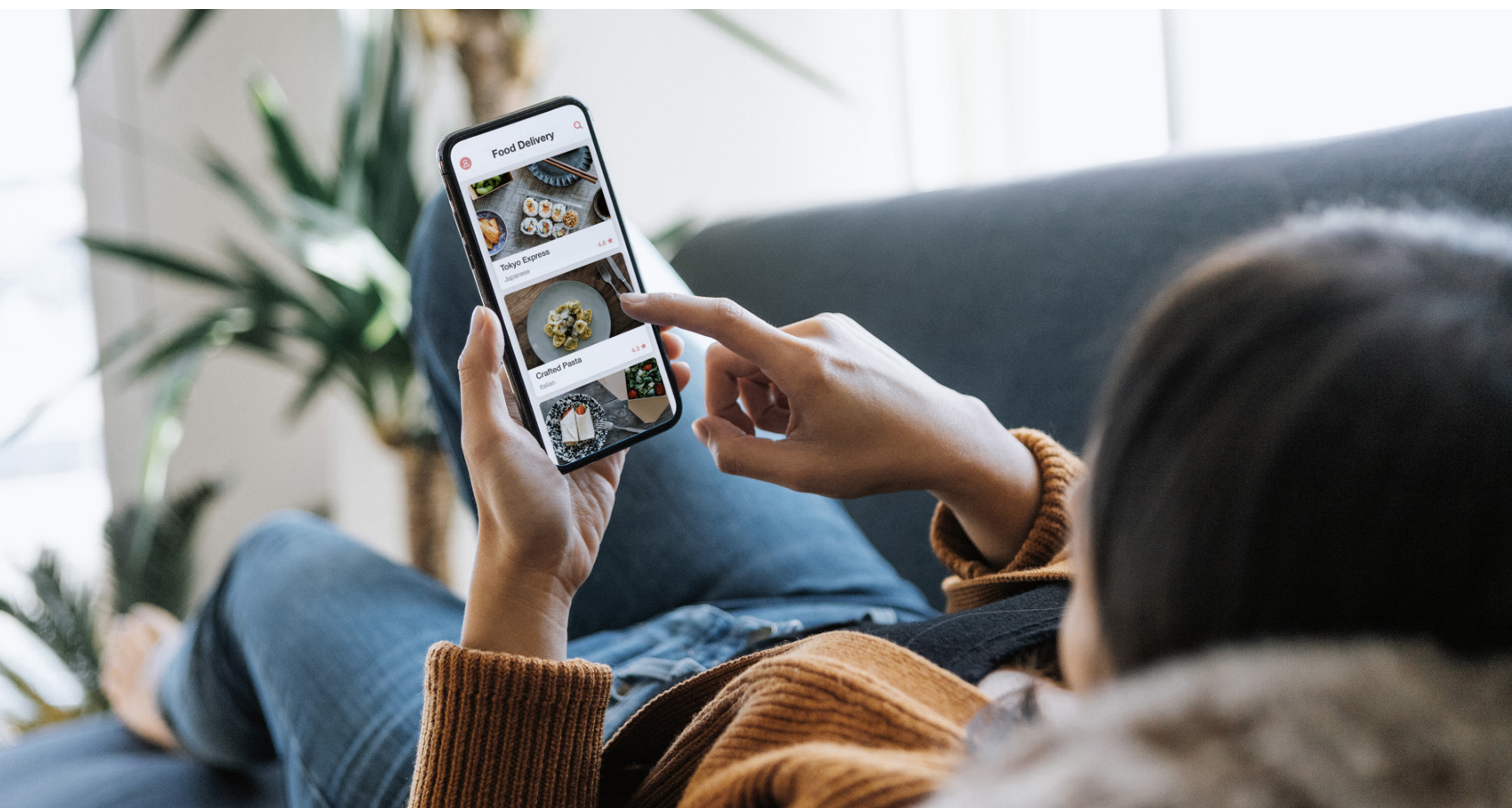
Ordering in: The rapid evolution of food delivery

Succeeding in the fast-growing food-delivery ecosystem will require understanding how overlapping economic forces affect a complex web of stakeholders.

by Kabir Ahuja, Vishwa Chandra, Victoria Lord, and Curtis Peens



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How the world eats is changing dramatically. A little under two decades ago, restaurant-quality meal delivery was still largely limited to foods such as pizza and Chinese. Nowadays, food delivery has become a global market worth more than $150 billion, having more than tripled since 2017. In the United States, the market has more than doubled during the COVID-19 pandemic, following healthy historical growth of 8 percent.

The advent of appealing, user-friendly apps and tech-enabled driver networks, coupled with changing consumer expectations, has unlocked ready-to-eat food delivery as a major category. Lockdowns and physical-distancing requirements early on in the pandemic gave the category an enormous boost, with delivery becoming a lifeline for the hurting restaurant industry. Moving forward, it is poised to remain a permanent fixture in the dining landscape.

Even as the food-delivery ecosystem continues to expand, its economic structure is still evolving. Considerations such as brand, real estate, operating efficiency, breadth of offerings, and changing consumer habits will determine which stakeholders win or lose as the industry develops. Potential regulatory constraints, including possible changes to how drivers are compensated, will figure into the reshuffling. And while the industry has experienced explosive growth during the global pandemic, delivery platforms, with few exceptions, have remained unprofitable. As DoorDash chief operating officer Christopher Payne told the *Wall Street Journal* recently, "This is a cost-intensive business that is low-margin and scale driven."[1]

Despite such challenges, there are still major investments happening in the space, with recent fundraises, including Wolt (which raised $530 million in January 2021), REEF Technology ($700 million in November 2020), and Rebel Foods ($26.5 million in July 2020), and consolidation, including Uber's acquisition of Postmates (for $2.65 billion in December 2020) and Just Eat Takeaway's acquisition of Grubhub (for $7.3 billion in June 2021). Two recent IPOs—DoorDash in December 2020 and Deliveroo in March 2021—demonstrate the excitement and uncertainty still present in the sector. As the landscape shifts further in the wake of the global pandemic, new challenges, opportunities, and decision points are emerging for a complex web of players—including delivery platforms, restaurants, drivers, consumers, and other tech enablers. In parallel, the emergence of rapid delivery/quick-commerce platforms that have themselves raised significant funding, such as Getir ($550 million in June 2021) and JOKR ($170 million in July 2021), adds a new class of competitors to the fight for "share of stomach."

Sizing the market

The most mature delivery markets worldwide—including Australia, Canada, the United Kingdom, and the United States—grew twofold (in the United States) to as much as fourfold (in Australia) in 2018 and 2019 (Exhibit 1). This exponential growth continued in 2020 and early 2021 to the point where these markets are now four to seven times larger than they were in 2018.[2]

Before the pandemic put thousands of establishments out of business, the US restaurant industry was growing 3 to 4 percent per year. Delivery sales were increasing at roughly twice that pace (7 to 8 percent). While population growth was a factor, the bulk of the increase came at the expense of the grocery sector, with millennials and Gen Zers preferring the convenience of prepared meals.

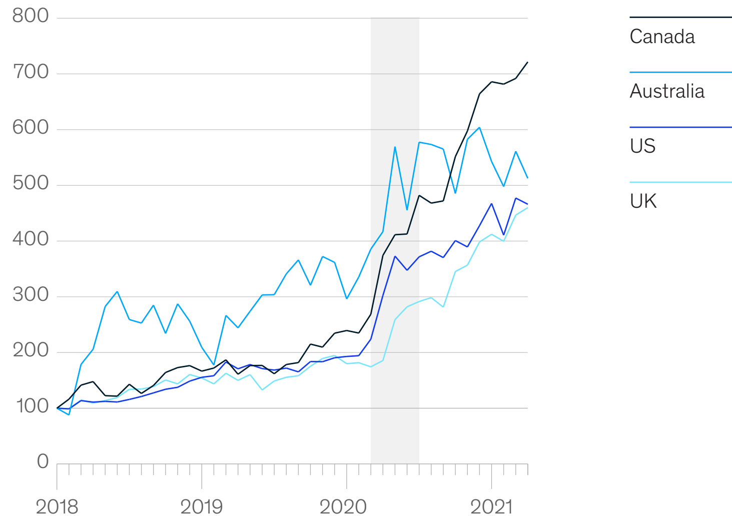
This trend toward convenience has grown more pronounced during the pandemic. Between March and May 2020, when lockdowns in Europe and the United States were the most severe, the food-delivery market spiked. Significantly, it has maintained that trajectory, continuing to grow throughout 2020 and into 2021.

[1] Preetika Rana and Heather Haddon, "DoorDash and Uber Eats are hot. They're still not making money," *Wall Street Journal*, May 28, 2021, wsj.com.
[2] *Global food delivery trends 2018 vs. 2021*, Edison Trends, September 2021, trends.edison.tech.

Exhibit 1

Since pandemic-related lockdowns started in March 2020, the growing food-delivery business has spiked to new heights in the most mature markets.

Normalized delivery-platform sales growth, index (Jan 2018 = 100)



Source: Edison Trends

As we move into the last quarter of 2021, with vaccinations spurring many cities to reopen even as the Delta variant becomes more prevalent, the permanent implications of the 2020 market surge should become clearer. This includes the extent to which eating habits that formed during the start of the pandemic will endure.

Emerging delivery battlegrounds

In the not-so-distant past, restaurants directly handled the limited food delivery that existed. These days, an entire ecosystem of players is involved.

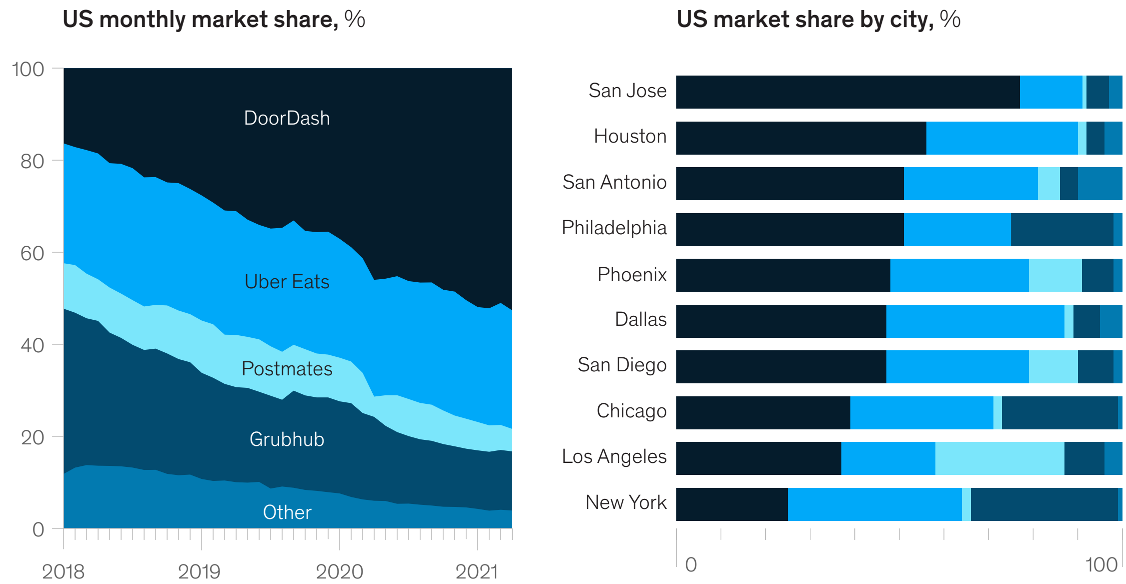
The United States is one of the more complex food-delivery markets, with four active players—DoorDash, Grubhub, Postmates, and Uber Eats—at the top, each commanding certain large urban markets. As of May 2021, DoorDash prevailed in San Jose (with 77 percent of the market), Houston (56 percent), Philadelphia (51 percent), and San Antonio (51 percent). Uber's 2020 acquisition of Postmates leveled the playing field, but only slightly. Combined, Uber Eats and Postmates led the market in Los Angeles (50 percent) and New York City (41 percent) as of May 2021 (Exhibit 2). These figures change monthly as platforms continue to vie for local markets.

As the food-delivery business continues to expand, a few key factors, from market dynamics to legal and regulatory issues, will help determine the levels of success for the various players.

— *Geographic competition among delivery platforms will be one of the most significant battlegrounds over the coming years.* Rival platforms will continue to fight one another for customers, restaurants, and drivers in each individual market, potentially leading to further consolidation over time. This battle will extend into new verticals beyond restaurants, as platforms widen the scope of services they provide.

Exhibit 2

Led by DoorDash and Uber Eats (which acquired Postmates in 2020), the top US food-delivery players continue to vie for different urban markets.



Source: Edison Trends

Adding to this competitive environment, specialized delivery apps focusing on a single customer segment or cuisine type—such as Slice, for pizza, and HungryPanda, for Chinese—have also come to market successfully in recent years.

— *Commission rates for restaurants are another major point of contention.* Delivery platforms make their money through five key revenue streams: restaurant commission fees (platforms typically charge restaurants about 15 to 30 percent of the price of a meal), customer delivery fees (usually $2 to $5 per order, collected directly from the customer), customer-service fees (surcharges of up to 15 percent, on top of delivery fees), in-app advertising (with platforms able to position brands and products based on customer-preference data), and tips (which go directly to drivers but which effectively subsidize platforms' operating costs). Restaurant commission fees are particularly contentious. During the pandemic, several local and state governments in the United States have imposed caps on these commissions, and some places are considering making these caps permanent. In areas where they are eventually lifted, traditional restaurants will once again feel the commission squeeze—particularly given that the platforms themselves are now larger and more powerful than they were before the pandemic. At the same time, as the *Wall Street Journal* notes, platforms—"mindful of restaurants' pullback"—are experimenting with offering restaurants different commission rates and terms.[3] It remains too soon to say where this will settle.

This pressure on traditional restaurants could be tightened further by the proliferation of "dark

[3] "DoorDash and Uber Eats are hot," May 2021.

kitchens" (a restaurant that has no front of house for customers) and other delivery-first and delivery-only restaurant models. Since these lower-overhead businesses can afford to pay the platforms' higher commissions, they are often featured more prominently in the platforms' apps. They may also be able to lower the service fees placed on customers. Increasingly, a greater share of delivery volume is likely to go their way at the expense of traditional restaurants, some of which may be forced to consider whether they can afford to continue playing in the delivery space at all. At the same time, dark kitchens also present an opportunity for restaurants, which may choose to supplement their on-premises facilities with remote locations devoted exclusively to delivery.

— *Driver compensation and benefits constitute another persistent hot-button issue.* Delivery platforms rely on the gig economy, with its system of on-demand drivers offering much-needed flexibility. This model, however, is still in flux, amid an ongoing national (and international) debate about whether gig workers, particularly drivers, should be considered employees. Shifts in how independent contractors are paid, as well as what benefits they receive, could significantly shake up the economics for all major stakeholders across the marketplace.

Evolving stakeholder economics

As consumer expectations and regulations evolve over the coming years, and as emerging technologies continue to reshape the industry, the long-term economics will likely look different than they currently do. To better understand how the landscape is poised to shift, it's helpful to delve into the economic and cultural forces affecting restaurants, food-delivery platforms, drivers, and customers.

Restaurants

Historically, restaurants have measured their profits against three basic costs: food (generally 28 to 32 percent of total costs), labor (another 28 to 32 percent), and occupancy- or real-estate-related costs (22 to 29 percent). Looking at a unit economics view of a restaurant, the business should run between 78 to 93 percent—allowing for a profit margin of between 7 to 22 percent (franchise restaurants pay additional franchise fees to corporate).

Delivery orders used to be viewed as an extra table for the restaurant, serviced by a driver instead of a waiter. Drivers were paid minimum wage by the restaurant and earned tips from customers, typically delivering several orders at a time within a set radius. Overall, delivery was intended to improve a restaurant's revenue by increasing the utilization of its kitchen at a decent margin.

Increasingly, a greater share of delivery volume is likely to go to dark kitchens, while some traditional restaurants may consider not playing in the delivery space at all.

As the COVID-19 pandemic began to pose an existential threat to restaurants, delivery became a saving grace. Many restaurants that delivered through online platforms were able to grow their delivery revenue throughout 2020. Even so, their overall profits generally declined, occasionally resulting in negative margins (Exhibit 3). This trend may have been accelerated by dining restrictions imposed during the pandemic, but the gap between delivery-fueled revenue spikes and profit declines was already an underlying issue.

Realistically, restaurants' traditional profit margins of 7 to 22 percent make covering the platforms' delivery commissions, roughly 15 to 30 percent, unsustainable as delivery orders become a larger part of a restaurant's business. This is less of a problem when in-house diners, who order high-margin items such as wine and other alcoholic drinks, help cover the costs of occupancy and labor. But the business model is seriously threatened when in-house dining dwindles.

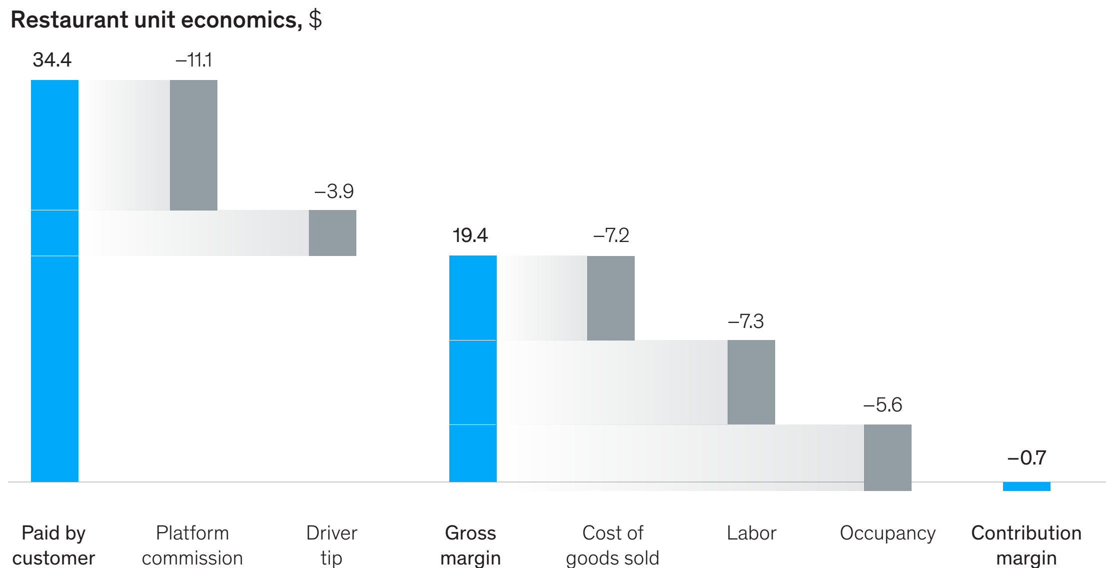
With fewer in-house diners, delivery must cover a greater share of restaurants' fixed operating costs. If the delivery business grows to such an extent that it requires more physical kitchen space to fulfill, the fixed costs could also increase.

Increasing total sales through delivery may look like a smart way to dilute fixed costs, but restaurants that focus too much on increasing deliveries could cannibalize their in-house dining and compromise the quality of the dining experience, which could eventually reduce the base over which their fixed costs are spread.

At the same time, a booming delivery business could mean that everyone has to work harder—from the cooks to the managers to the maintenance staff. Restaurants will likely need to introduce new processes and systems to accommodate high volumes of delivery orders. Ultimately, restaurants should thoughtfully balance delivery against other parts of the business to

Exhibit 3

While delivery has helped many restaurants weather the COVID-19 pandemic, the added costs make the current model unsustainable for the long term.



Source: Edison Trends; National Restaurant Association; McKinsey analysis

ensure that the net impact is positive. As Exhibit 4 illustrates, a typical restaurant would have to increase its total sales significantly to stay at the same profit margin it enjoyed without delivery.

The pizza segment sheds light on how the broader restaurant industry may grapple with the delivery conundrum. Most pizza restaurants have chosen either dine-in or delivery as their primary offering and have anchored their business models around it. It would not be surprising to see restaurants in other segments of the market also deciding to specialize in the experiences they offer, with those built around the dine-in experience potentially choosing not to play in the delivery space, because of their inability to compete on margin. This would leave dark kitchens and other delivery-focused businesses to compete for delivery volume.

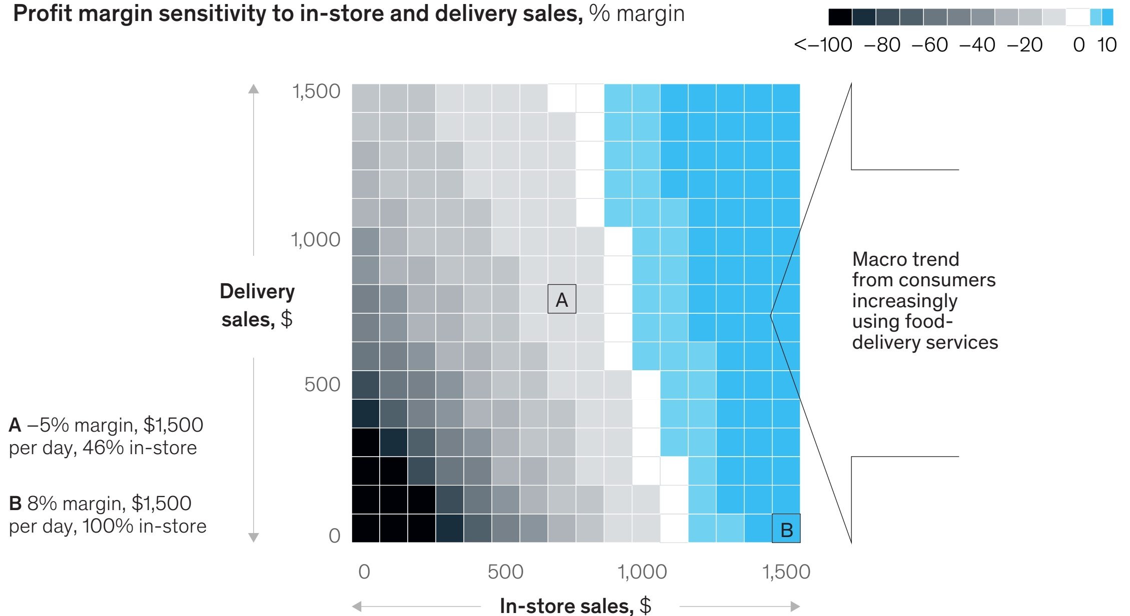
Restaurants that choose to continue serving both dine-in and delivery customers will need to adapt their pricing to cover delivery's additional costs. Those that favor pricing consistency could raise overall menu prices to cover these costs, with dine-in and pick-up customers effectively subsidizing delivery. Alternatively, restaurants could create separate, higher-priced delivery menus, as some have already done. As Chipotle Mexican Grill's chief financial officer, Jack Hartung, told Yahoo Finance Live in early February, after a 13 percent rise in delivery-app prices was announced: "It's no surprise that delivery comes with an added cost. Our belief has been that's a premium experience from a convenience standpoint. We want to make sure that channel covers the cost."[4]

Delivery platforms

The pressure is on for the platforms. Despite explosive growth, they are struggling to make a

Exhibit 4

Restaurants should carefully balance delivery growth against core, in-store dining to ensure that the net impact is positive.



Source: National Restaurant Association; McKinsey analysis

[4] Brian Sozzi, "Why Chipotle just raised prices," Yahoo Finance, February 3, 2021, yahoo.com.

profit. And, as the *Wall Street Journal* has reported, these companies aren't expected to become profitable for a number of years.[5] Nonetheless, there is opportunity for upside, as platforms tap into new revenue sources and curb certain costs.

Platforms' current economics are driven largely by fees and commissions paid by restaurants and customers, as well as delivery costs (Exhibit 5). Our analysis shows an average contribution margin of around 3 percent, or roughly $1.20 on the average order.

The cost of delivery is unlikely to decline substantially, as the economics of last-mile delivery remain challenging across sectors, particularly with increasing expectations for speed (typically, 30 minutes or less). However, new technologies (such as autonomous delivery robots), improved routing, and the ability to batch or "stack" multiple orders per delivery should help.

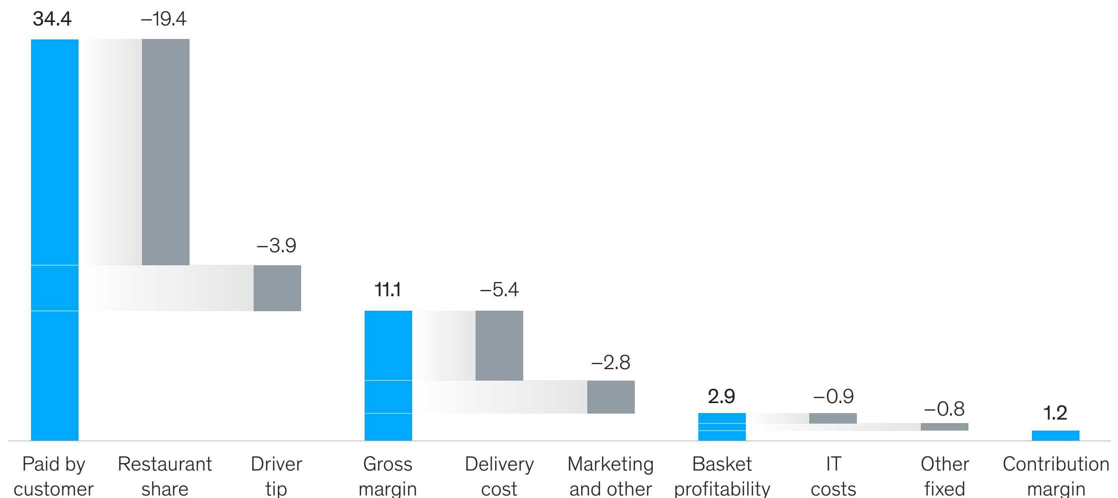
Another important consideration is variable marketing costs, such as advertising. With multiple high-profile players competing in the market, and as restaurants and chain brands are fragmented across platforms, the current cost of attracting customers is becoming unsustainable. As platforms are being combined through acquisition, this cost should decline. Consolidation will also give the platforms an outsize influence over which of the thousands of restaurants are seen by the customer—likely resulting in the further consolidation of volume to leading restaurants, whose brands are well positioned to play in the digital marketplace.

Delivery platforms will likely not see any significant margin growth in the restaurant space, given the economic squeeze that restaurants are already facing, as well as the increasing pressure from platform commissions. But when it comes to consumer demand, delivery platforms are still only scratching the surface. As they continue to tap into

Exhibit 5

Despite explosive growth, online food-delivery platforms are still struggling to make a profit.

Delivery-platform unit economics, $



Source: Edison Trends; National Restaurant Association; McKinsey analysis

[5] "DoorDash and Uber Eats are hot," May 2021.

Delivery platforms are poised to generate profits at scale if they can unlock the logistics, operational requirements, and challenges of last-mile delivery.

this vast pool of potential demand, platforms are poised to grow their overall volume and generate profits at scale—if they can unlock the logistics, operational requirements, and challenges of last-mile delivery.

Already, many platforms are expanding the use cases for their logistics networks. This activity is likely to increase, with platforms improving their overall economic profiles by delivering other, higher-margin products in new categories such as alcohol, pharmaceuticals, grocery, and more. These new categories attract new customer segments, increase average order value, and allow for the stacking of deliveries to help maximize efficiency of each delivery run.

They also position the platforms to become service providers to businesses beyond restaurants. As the *Wall Street Journal* notes, DoorDash provides delivery services for companies including Petco, Macy's, and Walmart.[6]

Drivers

Delivery drivers must complete a certain number of deliveries per hour to make the economics favorable for them. In fact, time is one of the most expensive components of single-point delivery, with the physical handoff to the customer typically taking one to five minutes. As food delivery takes off in less densely populated locations, including suburban and rural areas, the service becomes more costly to both restaurant and driver.

As previously discussed, major changes in how independent contractors are compensated would have significant ripple effects throughout the food-delivery ecosystem. Barring such changes, pay per delivery will likely continue to decline in real terms as platforms become more efficient and facilitate more total deliveries per hour. However, with substantial increases in volume, as well as enhancements in platforms' logistics technology, it is conceivable that overall pay per hour could rise slightly for drivers over time, as they are able to complete more deliveries per hour.

Customers

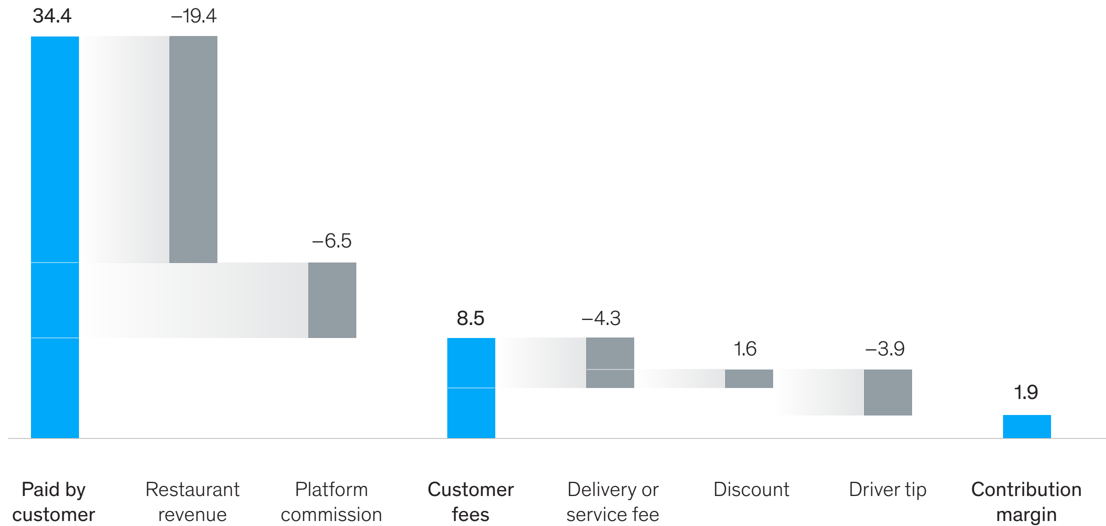
The customers fueling the surge in food delivery are paying a significant premium over the cost of their average order. If a typical meal from a fast casual restaurant is priced on a delivery platform's menu at around $25, the customer might end up paying a total of roughly $35, excluding tax (Exhibit 6). Customers' total costs include delivery fees ($2 to $5 per trip), driver tips (usually around 10 to 20 percent), and platform service fees (which are often offset by discounts but generally come out to around $3). Customers do not directly see the service commissions that restaurants pay

[6]Ibid.

Exhibit 6

Customers fueling the growth in food delivery are paying a sizeable premium over the cost of their average order.

Average US food-delivery bill per order, $



Source: Edison Trends; National Restaurant Association; McKinsey analysis

platforms. Some restaurants raise their delivery-menu prices to cover this cost, while others opt for pricing consistency, spreading the markup among all customers.

Even as customers are paying a 40 percent premium on the cost of their actual meal, it is worth noting that restaurants themselves receive around only 55 percent of the total customer spend.

For much of the ongoing pandemic, many people have had few other restaurant options than to order delivery and have been willing to pay a significant premium for the service. More than a year and a half into the pandemic, a growing number of consumers (particularly those who are vaccinated) are becoming more accustomed to ongoing restrictions and more open to dining out. As dining options begin to increase, customers will likely expect more from food-delivery services, prioritizing the following features:

— speed of delivery, with a goal of under 30 minutes being a differentiator among platforms

— quality of food, with an expectation of restaurant-quality meals even after transit time

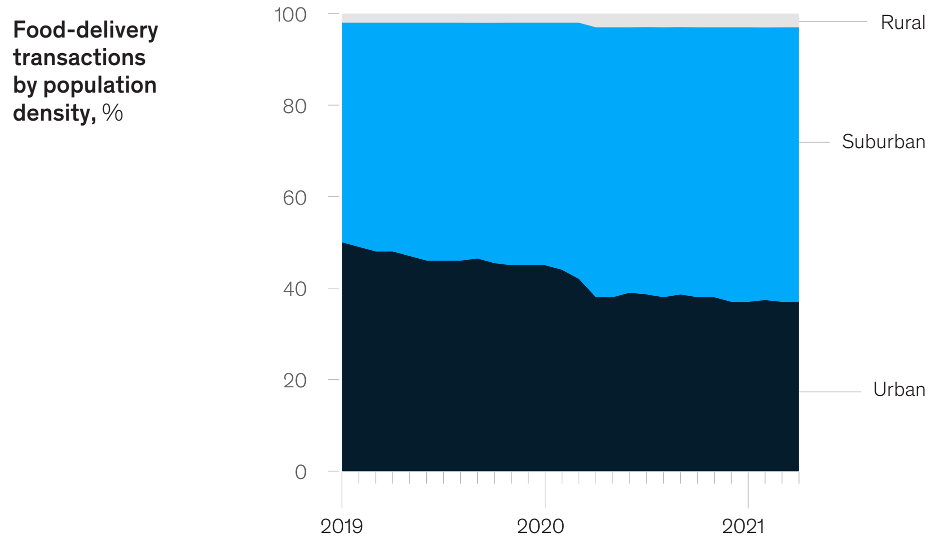
— 100 percent order accuracy and completeness, for regular items as well as special requests

— variety in cuisines and meal occasions

High population density and big-ticket orders tend to make food delivery more efficient. As the footprint and economic profile of delivery expands to meet more and varied customers, platforms and restaurants will need to figure out how to serve these different population segments—for example, customers who tend to spend less money on meals, as well as those who live in sparsely populated areas, far apart from one another and from the restaurants serving them (Exhibit 7).

Exhibit 7

As food delivery expands into less densely populated areas, platforms will need to figure out how to serve those customers more economically.



Source: Edison Trends; McKinsey analysis

Moving forward, consumers will likely see the cost of their restaurant meals increase (through additional listed fees or menu markups) in order to cover restaurants' commission costs and driver pay. These fees and markups may eventually decrease as restaurants and delivery platforms become more efficient at scale.

In one example of a market shift that could increase customer retention while also benefiting consumers, many delivery platforms have begun offering monthly subscription services, following similar models such as Amazon Prime. With DoorDash's DashPass, for example, or Uber Eats' Eats Pass, customers pay a monthly fee for unlimited free deliveries. These offers reduce the cost burden for customers who order frequently and make the cost of attracting customers more worthwhile for platforms, as customers become more loyal.

New opportunities and untapped revenue pools

As the way people eat continues to evolve, new revenue pools are emerging. Tapping into them will require creativity and a willingness to overhaul operating models built for a different time. The following revenue models are among the most promising:

'Menu engineering'

Using the data generated through delivery platforms, restaurants can build custom menus for each consumer, increasing opportunistic sales, total order value, and conversion rates. End-to-end customization helps ensure that customer preferences, such as food allergies, are taken into account for every meal and that food recommendations are more accurate.

'Dark kitchens'

Also called ghost kitchens, dark kitchens market and produce delivery orders but have no physical

restaurant or storefront attached. They take delivery out of the "front of house," allowing restaurants to expand and experiment with minimal investment risks. REEF Technology, with its Neighborhood Kitchens concept, is among the companies offering established and upstart restaurants access to dark kitchens (among other infrastructure and services).

Virtual brands

These are incremental offerings targeted at new meal occasions or cuisine types, developed to increase a restaurant's online presence and capture a different market segment. Virtual brands can help attract new customers, improve labor efficiency, and optimize order stacking for delivery platforms. YouTuber Jimmy Donaldson (known as MrBeast) parlayed his popularity into MrBeast Burger, a virtual brand whose menu items are prepared in existing restaurant kitchens across the United States and in the United Kingdom. Man vs Fries, which started as a Bay Area pop-up, has expanded its virtual brand into several cities, including Atlanta, Miami, and Seattle.

Brand spin-offs

In a digital world, restaurants that enjoy a great deal of brand loyalty in their communities have an even greater opportunity to consolidate their position and grow their business by creating spin-offs targeting new demographics or meal occasions. Au Cheval, for example, the diner-style Chicago restaurant and bar revered for its cheeseburgers, has spawned Small Cheval, which offers a simplified menu. The potential to leverage brand equity in this way is greater with digital ordering and delivery, as consumers turn to valued brands regardless of where they are located.

Consolidation points

One of the largest costs of last-mile delivery stems from poor route optimization when making multipoint pickups and drop-offs. Partnerships with nearby restaurants could help develop a "food hall"-like online market to improve the customer experience and offer more variety. Solutions such as Toronto's Kitchen Hub Food Hall allow customers to place a single order that includes items from multiple restaurants. Families that can't agree on what to have for dinner can include a variety of cuisines, such as burgers, sushi, and stir-fry, on the same order.

Virtual concierge

Drivers and consumers alike stand to gain from efficiencies achieved when multiple deliveries are consolidated, or "stacked." Virtual concierge services make this possible—for example, by having a driver pick up a customer's dry cleaning or groceries in addition to their restaurant order. These services can also stack orders from different customers who live in the same apartment building or neighborhood. Rappi, based in Bogotá, Colombia, is an example of a multivertical delivery app that combines food delivery with other errands (through services such as RappiFavor or RappiCash), while Uber Eats and DoorDash have started exploring order stacking as part of their food offerings.

Tiny restaurants

Restaurants may want to rethink their design approach in light of the growing delivery market. Burger King, for example, recently unveiled plans for a restaurant that is 60 percent smaller than its traditional outposts, accommodating the influx of to-go orders with features such as "pickup lockers" and dedicated curbside-delivery parking spots.

Innovation in customer attraction

The evolving food-delivery ecosystem requires, and will likely reward, creativity. One potential example: combining dining and television with "taste your favorite cooking shows at home" type of offerings, in which meals are delivered so that viewers can dine at home "alongside" their favorite celebrity chefs. Rachael Ray partnered with REEF and Uber Eats in 2019 to launch her latest cookbook, offering fans in certain cities the opportunity to sample her recipes without so much as turning on their ovens. "It's me, joining people for dinner," said Ray.[7]

[7] Kate Krader, "With Rachael Ray, Uber Eats starts virtual celebrity restaurants," Bloomberg, October 10, 2019, Bloomberg.com.

Check, please

Though a great number of restaurants have suffered and even closed during the COVID-19 pandemic, the surge in tech-enabled delivery has been a meaningful silver lining for many. And for homebound customers, the arrival of steaming hot curry or burritos or filet mignon—summoned with a few clicks or swipes—has been revelatory.

Going forward, the food-delivery space is poised for further expansion and evolution as the "next normal" takes shape. Restaurants will need to adapt their strategies, think carefully about how to partner with delivery platforms, and experiment with new ways of doing business. Delivery platforms will need to evolve how they leverage customer data to improve the user experience and find innovative ways to reduce the costs associated with delivery. And as investors pour money into delivery platforms, dark kitchens, new brands, and other infrastructure and services, the companies on the receiving end will face substantial pressure to live up to investors' expectations.

As these changes in the way the world eats take hold, the implications for new and established businesses, as well as for consumers, will continue to take shape. Unlocking the opportunities inherent in these shifts will require a sophisticated understanding of where the market is heading and the powerful forces shaping its trajectory.

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