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The Economics of Quick Service Restaurant Delivery Partnerships

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ABSTRACT

Large chain fast food restaurants, also known as quick service restaurant (QSR) are known for price and convenience. However, one critical factor that is lacking for many QSR restaurants is customer delivery. For restaurants that offer delivery, the increased availability to the consumer can offer a substantial competitive edge. With the advent of third party delivery, those restaurants which heretofore were not able to deliver, now have the opportunity to partner with third party delivery providers. In a similar war, restaurants that simply lack an online presence can look to order aggregators to fill their needs. The size and allocation (between the customer, the restaurant, and the delivery provider) of delivery fees are major factors impacting the viability and success of these partnerships. Due to the low average price point in the QSR business, delivery charges can have a significant impact on margins. The purpose of our research is to explore the economics of delivery fee determination and allocation, paying close attention to scalability and efficiency. We will also attempt to discern the maximum delivery fee consumers would be willing to absorb given QSR's low average ticket price.

Keywords

Third party delivery, Quick Service Restaurant (QSR), delivery fee distribution, restaurant delivery economics

1 INTRODUCTION

The large chain food delivery space has long been dominated by pizza chains such as Dominos, Papa Johns, and "Yum! Brands" Pizza Hut. The integration of delivery into their prospective business models has created something of a strategic advantage over the rest of the QSR industry. In recent years, the QSR market has shifted with the rapid adaption of third party delivery services. In past two decades, third-party aggregators and delivery businesses have reshaped the QSR market and continue to grow at a ferocious pace. As competition grows, their methods and strategies will continue to be tested and reshaped by the various stakeholders involved.

2 COMPANIES THAT PROVIDE THIRD PARTY DELIVERY

The first major player in the restaurant order aggregation business was Seamless. Founded in 1999 by attorney Jason Finger, the business was originally called SeamlessWeb. Finger was working long nights at a New York Law firm and often found himself responsible for ordering food for his coworkers. He was struck by the lack of online information regarding restaurant hours and menus. His disappointment was his inspiration as he set out to create an industry. Within a few months he had raised \$347,000 from 44 separate people and SeamlessWeb was born. Ironically, one of the original main goals had nothing to do delivery. He had planned to create a service to make it easier for companies to establish their food budget restrictions. Employees could order through seamless and the restaurant could charge the company directly. The company would then pay the restaurant directly, entirely eliminating the employee reimbursement process. From 1999 until 2005 Seamless exclusively served business customers. In 2005 the business was expanded to serve individual consumers. In 2006 Seamless was bought by Aramark for an undisclosed amount. (Morell, 2013)

GRUBHUB was founded in 2004 by engineer Matt Maloney and his co-worker Mike Evans. They wanted to create a website from which customers could browse menus from different restaurants and place orders directly. Matt and Mike gathered menus from restaurants throughout the Chicago area and began to develop a website. Their first plan was to provide \$140 for six months placement on the GRUBHUB website. Few restaurants jumped at the offer as many doubted the value of their new little-known website. When GRUBHUB adjusted their fee structure to a 10% commission of online sales, growth really took off. As the

business grew, they looked for an opportunity to expand into another city. They hired a San Francisco manager who pitched their website to local restaurants and expanded their network. This acted as a momentum boost for securing venture capital. In November 2007 they were able to secure their first round of venture capital funding.

GRUBHUB and Seamless began as major competitors. Although their original vision was not identical, they were growing more alike as they matured. They were operating in a similar fashion as each expanded rapidly and introduced this new kind of restaurant relationship. When Seamless and GRUBHUB merged in August 2013, the deal allowed both brands to prosper. GRUBHUB was developing across the country and Seamless had an incredible foothold in the New York market. By combining their businesses, they were able to grow both brands and continue to chase their vision. In 2010 the company launched mobile ordering. This feature had two main aspects: the ability to order using a mobile phone and the ability for restaurants to receive orders using a tablet (up until this point restaurants had received orders through fax). This update took their process into the modern age and eliminated the need for paper and ink. As a result, restaurant became better equipped to handle large order flows. (Welch, 2014).

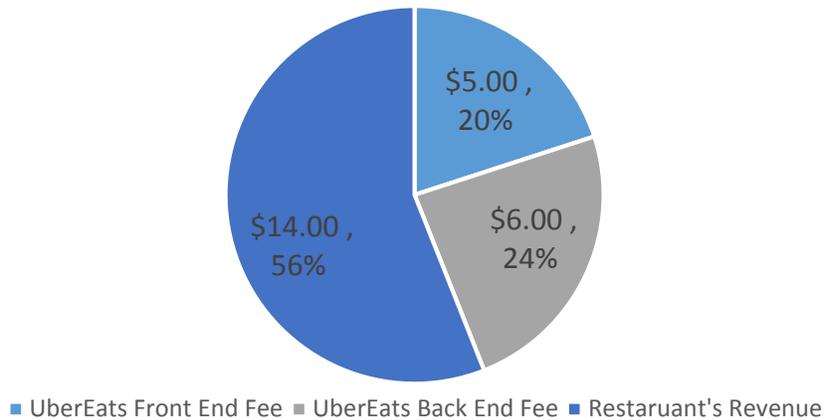
3 AGGREGATORS VS THIRD-PARTY DELIVERY PROVIDERS

Aggregators and third-party delivery businesses are each playing a crucial part in the transformation of the restaurant industry. Aggregators allow fast and easy online ordering, while third party delivery businesses create the opportunity for restaurants to serve new markets (without the need to develop their own delivery businesses). Olo is a highly successful aggregator. Restaurants pay monthly fees to Olo, which in turn provides the restaurant with an online menu accessible through web browsers and mobile applications. The interactive menu is able to process orders and can be linked with third party delivery providers. Restaurants that have partnered with Olo have seen impressive growth. Between 2016 and 2017, restaurants that partnered with Olo have seen same store sales (a common performance metric in the restaurant industry) climb 30%. EatStreet is another aggregator that is available in more than 250 cities and is partnered with more than 15,000 restaurants. EatStreet allows customers to view (and order from) restaurants in their area that deliver. Customers can view menus, food prices, delivery time estimates, and delivery fees. Restaurants receive orders directly from EatStreet, prepare the food, and deliver the food. Eat street is most known for markets where third party delivery is unavailable. As the third-party delivery industry expands into these markets EatStreet will likely need to update their business model to include third party delivery. Olo, EatStreet, and other online aggregators are highly successful in their established markets. Door Dash is a third-party delivery service. While Olo and Eat Street aggregate orders online, Door Dash delivers them. Restaurants can focus on making food while Door Dash handles delivery. In the past few years, aggregators and delivery providers have expanded to cover considerably more geographic territory. In their most mature markets, aggregators show dominance over online ordering in the restaurant industry. In the UK 70% of online restaurant orders are placed through aggregators. In Turkey that number is 90% (Whitten, 2018).

4 FEES AND SPLIT ARRANGEMENTS

In order to predict the growth and success of third party delivery, it is necessary to understand the fee structure. Third party delivery providers often charge two different kinds of fees. One type of fee is charged to the consumer and is listed on the bill that the customer receives. This fee is very transparent to consumers and for purposes of this paper will be known as the “front end fee.” The second fee is charged to the restaurant. As the creators of GRUBHUB learned, this fee is best charged as a percentage of sales. This fee is less transparent as it does not appear on the consumers receipt and for purposes of the paper will be known as the “back end fee.” UberEATS collects a front-end fee from customers based off of factors like the distance travelled from the restaurant to the travel site and the demand for delivery at that particular moment in time. A typical front-end fee can be around \$5. UberEATS typically charges a back-end fee of around 30% of the restaurant bill. If a consumer placed an order for what would normally cost \$20 at a restaurant, they would likely pay a bill of \$25. \$6 out of the \$20 restaurant bill is taken by UberEATS as a back-end fee and \$5 is added on as a front-end fee. In exchange for \$20 of food the customer pays \$25, the restaurant receives \$14, and, UberEATS receives \$11. For some restaurants, the 30% back end fee can seem prohibitively expensive. Each restaurant must determine if this relationship is beneficial based on their individual financial position (Keng, 2018).

Figure 1: Hypothetical UberEats order for \$20 of food (\$25 cost)

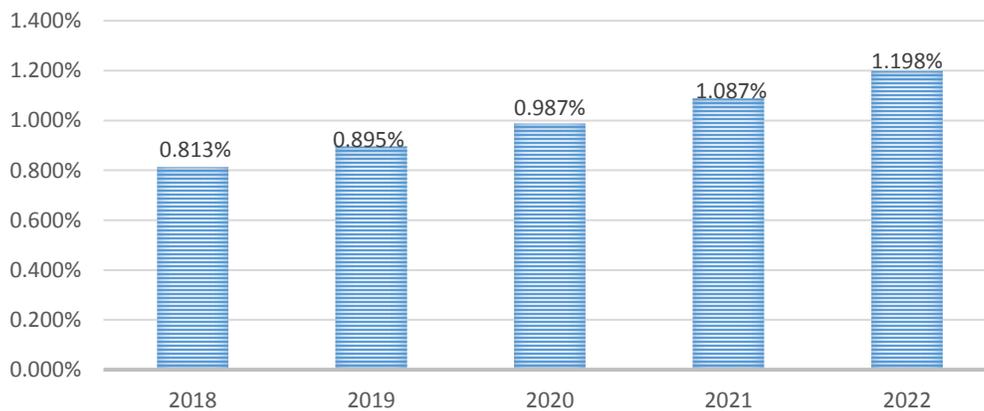


Based on studies in five cities (Atlanta, Boston, Chicago, Dallas, and Los Angeles), the average ticket price for restaurants using third party delivery was \$22.41 (Seelevelhx, 2017). GRUBHUB’s average front end cost was \$3.11, Door Dash’s was \$3.17, Post Mates’ was \$4.95, and UberEATS’ was \$5.01. In these markets, when projecting growth and future success it is essential to consider price and price elasticity of demand. Surveys asked consumers to name prices they felt comfortable paying for delivery services. Responses showed that \$8 would be “too expensive”, \$6 would be “getting expensive”, \$3.60 was “a great deal”, and \$1.75 would lead consumers to question the quality of the delivery service provided. Based on the fact that none of the four aforementioned third-party delivery providers reached the “getting expensive” price of \$6 and none were anywhere close to the “too expensive” price of \$8, it appears that there is a certain amount of price elasticity in terms of the front-end fees charged by these third-party delivery providers. According to the survey, GRUBHUB and Door Dash (with average charges of 3.11 and \$3.17 respectively), came in below the \$3.60 mark described as a “great deal.” It is possible that if the back-end fee ever faces downward pressure, the revenue models could be shifted to push more of the cost onto the consumer. (Upton, 2018)

5 GROWTH

The growth in third party aggregators and third-party delivery providers has been tremendous. Growth is projected to continue at an astounding rate. As of March 1st 2018, the U.S. third-party food delivery market (consisting of delivered restaurant meals and delivered groceries) sat at \$13 billion. It is expected to grow at a 13.5% annual rate to \$24.5 billion by 2022. The overall U.S. food market sat at \$1.6 trillion and has an overall growth rate of only 3.0%. As of March 1st, 13% of consumers interviewed had ordered using third party delivery. QSR restaurants (in conjunction with third party delivery providers) are making a strong push to capture part of the delivery market share currently held by the pizza brands (Dominos, Papa John’s, and Yum! Brands Pizza hut) that have long dominated the QSR delivery market.

FOOD DELIVERY AS A % OF THE TOTAL FOOD INDUSTRY



Restaurants can take comfort in the fact that growth through third party delivery is largest incremental. Less than 20% of delivered meals replace a restaurant visit. Given that 80% of delivered meals are incremental and only 20% are cannibalistic, restaurants can pursue third party delivery without the fear that they are simply rearranging their existing customers. (Upton, 2018) One in four consumers said that they spend more when ordering off premises. This can help restaurants as ticket sizes grow from online ordering (PRS, 2018).

6 CONCLUSION

Based on rapid adaption and integration of order aggregation and third-party delivery services in the restaurant industry, it appears likely that the industry will experience continued financial success. With customers willing to pay current prices (and then some), players like UberEATS and GRUBHUB are poised for success. The incremental growth for restaurants involved in these partnerships appears to support the idea that restaurants will continue to favor these relationships. The fee structure, however, may need alteration. While restaurants are squeezed for up to 30% of their delivered sales, surveyed consumers show some upward flexibility from current price levels. As the market matures, the “dust will settle” and effective strategies will become more apparent.

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