Delivery - the food sector's ugly duckling

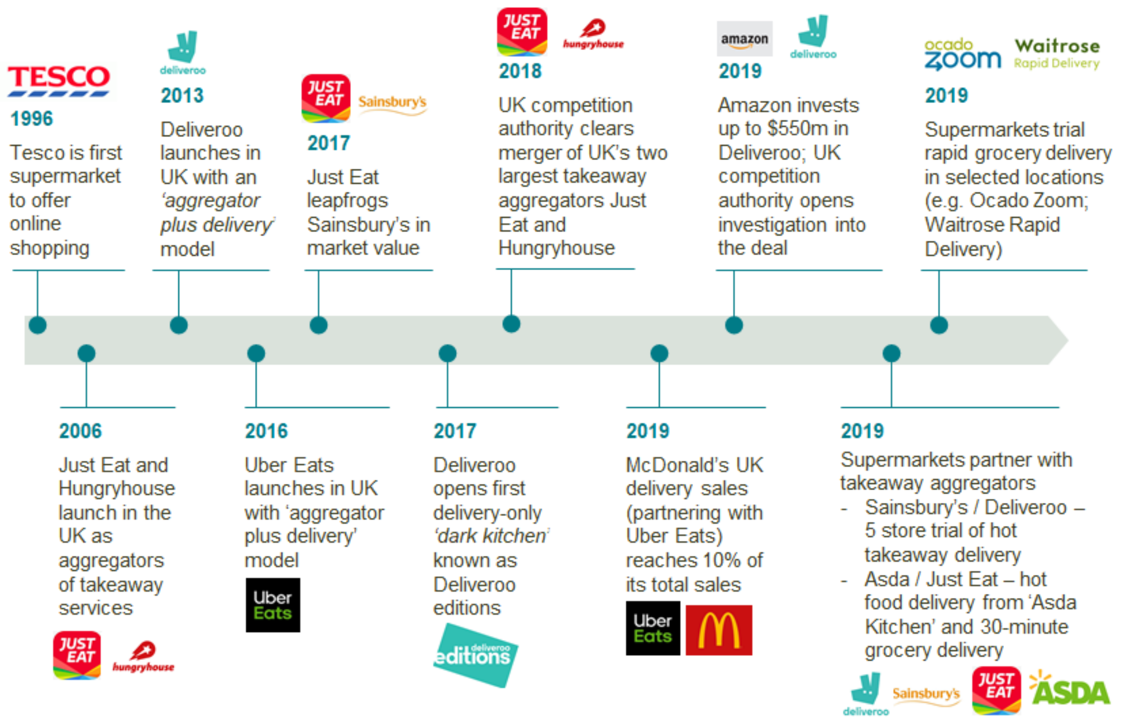
A tough start and a promising future…

There is at least one in every family: someone who is different, who kicks against the status quo, who doesn't quite fit in. Like gravity, one *ugly duckling* per family is a universal certainty. I'm sure someone has popped to mind as you read this. Uncle Errol? Cousin Bertie? Auntie Marg? Take your pick.

The family affectionately known as the UK food industry, a family worth c.£130bn,[1] is no exception. **Food delivery** appears to be the industry's particular ugly duckling – historically restricted to the fringes of retail, used only occasionally and, when so, only under very specific circumstances.

But the last five years have witnessed a transformation. The delivery industry has blossomed (driven mostly by non-producers such as Just Eat, Uber Eats and Deliveroo) and is beginning to provide a competitive alternative to traditional food retailing. The recent investment by Amazon in Deliveroo and the fact that Just Eat now boasts a higher market cap than Sainsbury's indicates that at least some have begun to spot underlying beauty (see timeline of interesting developments).

Others remain sceptical, pointing to concerns such as supposedly unprofitable business models and low market share. Nothing new for an ugly duckling used to being bitten and pecked just for being different. But if nothing else, surely the story of that downtrodden bird has taught us to be more flexible in our thinking, not to rush to judgment and to consider alternate perspectives more carefully?



[1] Excluding alcoholic drinks (Office for National Statistics, Living Cost and Food Survey)

Shedding some final feathers…

Those familiar with the story of the ugly duckling know that he did not become beautiful overnight. It took time, patience and the shedding of a few feathers. The truth of the matter is that the consumer food market was not established with delivery in mind. This particular duckling may need to break away from traditional retail to realise its full potential. Consider for a moment the following characteristics of the sector, which by no means make for an efficient delivery system:

- **Store locations** – sites were not traditionally chosen to maximise delivery efficiency, i.e. they were not based on density of delivery demand and travel time. Shops are often located on high streets, their owners paying a fortune in rent in return for 'superior positioning'.
- **Labour costs** – traditional stores clearly differ in their staff requirements from those in a delivery network. This means that some staff functions (e.g. waiters and cashiers), and associated costs, are superfluous in a delivery network, and other resources are required.
- **Capabilities** – stores have typically focused on the in-store customer experience (e.g. layout, product positioning, aisle heights). But, with the boom in delivery, their focus must shift to the online customer experience (e.g. product listing, website design, payment process).

Traditional store characteristics in one way or another work against the efficiency of a delivery system. However, over the last half decade, food delivery has thrived in disregard of these obstacles. Perhaps partly driven by an outsider's willingness to challenge existing assumptions on price and value. Who would have thought people would pay £15 to have a lasagne brought to their door when they could pick it up for £4 at the local supermarket? Or that someone might pay a £4 delivery charge for a £3 burger?

Taking flight…

Many are wondering when the once-ugly duckling will take flight as a majestic swan, but the future appears uncertain. The market is in a state of flux and customer habits are still forming. Business models and capabilities are being tested, refined, enhanced and tested again to capture future value. This leads to many interesting areas to consider.

- **'Owning' the customer relationship**

  The ability to understand customer behaviour and influence user experience and decisions remains central. Up to now restaurants and supermarkets have controlled the customer relationship. But as Airbnb taught the travel industry, this relationship is a privilege, never to be taken as given. Restaurants and supermarkets will need to understand their value and negotiating power relative to third party delivery services. Among other factors, this will depend on how many customers each brings to the other. Failing to grasp this dynamic could relinquish control and profits to innovative third parties, especially if inflexible contracts prevent switching providers.

- **Adapting to a winner-takes-all scenario**

  Just Eat claimed victory in the *'pure aggregator'* market in 2018 when they acquired a flailing Hungryhouse. They have since co-existed alongside the *'aggregator plus delivery'* model (Uber Eats and Deliveroo). However, there is evidence that the two models are converging. That is, Just Eat is beginning to offer a delivery service and Deliveroo and Uber Eats are beginning to provide pure aggregator services to some restaurants. The number of players that can survive will depend, among other factors, on the minimum efficient scale of various models, the ability to differentiate offers and the impact of network effects.

- **Profitability of delivery business models**

  As companies chase growth in this market, they forgo profitability. Most food delivery services are loss-making, relying on new investors to fund these losses. While this in and of itself is not an issue, it is not a sustainable state of affairs. Delivery fee and commission levels are the obvious levers that could be pulled to influence the bottom line, but this rests on the assumption that customers or indeed restaurants or supermarkets will be willing and able to cover rate increases. Alternatively delivery businesses will need to cut costs by identifying more efficient operating principles.

- **Delivery's impact on existing business models**

  Similarly, existing businesses (restaurants and supermarkets) will need to work through what delivery means for their own economic models. For example, understanding delivery's contribution to incremental sales as opposed to cannibalising existing sales with a significantly lower margin. Or navigating the implications for existing store locations whose geography is not ideal for a delivery network.

These are big considerations - no doubt about that. As the swan prepares to take to the wing, the key will be to maintain flexibility, shape customer behaviour and continuously test, learn and adapt to market changes.

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