The dark side of the boom

Dark kitchens, delivery and maximising restaurant profits

An exclusive report by Mark Faithfull for MAPIC

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DELIVERY AND DARK KITCHENS

A mid the F&B boom, has come a second boom - in delivery. Driven by millennials, who think nothing of ordering in food two or three times a week and who expect fast service, wide choice and good value, a whole new industry has emerged to cater for their seemingly endless appetite.

Such has been demand that established restaurants have sometimes struggled to cope with a horde of motorbike helmet-clad couriers waiting in line for collection and have had to consider reconfiguring their restaurants to ensure the in-store experience is not impacted or move delivery out to so-called dark kitchens.

“Dark kitchens have been around for a very long time but the market has evolved and they have created opportunities for operators who, for example, might want to move into a new location for less investment or where they can’t find the right restaurant property,” says Peter Backman, UK-based restaurant consultant.

He adds: “Customers want delivery. They have been educated by the likes of Amazon to have things delivered to home and the challenge for the restaurant industry as a whole is to do it...”

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Delivery platforms are increasingly identifying where dark kitchens can meet an under-served demand
Dark kitchens, delivery and maximising restaurant profits

The dark side of the boom

For the operators these additional deliveries add a lot to the top line and a little to the bottom line but there is a need to do it because of the demand."

The industry's big hitters have already become directly involved. Food delivery specialist Deliveroo opened its first shared kitchen in Paris in July last year, having debuted this concept of shared kitchens - called Deliveroo Editions - in London in 2017. The company started with 12 kitchens in a warehouse in Saint-Ouen, next to north-west Paris. Restaurants can choose to pay a rent or get started for free and pay higher fees.

Deliveroo customers currently pay €2.50 per order for the delivery in Paris, while the company also gets a cut of the total order amount. Deliveroo said at the French launch: "The Deliveroo Editions site in Paris is a permanent bricks and mortar site, as are the majority of our Editions sites across the UK and Europe. All Editions sites are good for the local economy, work closely with local communities and host kitchens with high standards."

"The delivery-only super kitchens are state of the art and bring together amazing chefs from independent restaurants and high street chains all into one location, dramatically expanding consumer choice. This is good for the local economy, good for restaurants looking to expand and good for anyone who wants amazing meals delivered direct to their door."

In March of this year, it emerged that the food delivery company run by former Uber boss Travis Kalanick had snapped up London dark kitchens firm Foodstars last year, as he looks to expand his new venture in the UK.

City Storage Systems, which trades as Cloud Kitchens in the US, quietly bought the start-up, according to documents filed at Companies House. Foodstars was founded in Bethnal Green, East London in 2015 and operates kitchens across London, which it leases to restaurants focusing on selling food through delivery apps such as Deliveroo and Uber Eats. The acquisition marked Kalanick’s first expansion outside the US.

Hosting different restaurants in this way has multiple benefits. Firstly, it allows operators to offer a wide variety of different cuisines from a single location, appealing to a broad spectrum of consumer tastes. What’s more, dark kitchens enable restaurants without their own delivery services to tap into the lucrative home delivery market. Working closely with the chefs of the original restaurants, dark kitchen managers can ensure that standardised dishes are produced which match their brand. The sharing of ingredients across different brands in a dark kitchen also improves economies of scale.

Another crucial value in the dark kitchen model lies in changing menus quickly and easily. Many traditional restaurants open in response to changing tastes and trends, leaving them vulnerable to the latest food fads. With no physical premises to refit or remodel dark kitchens can change their menus – or even the entire concept of their restaurants – quickly and easily.

While proprietors of dark kitchens do miss out on walk-in sales and the high mark-ups of drinks purchases from dine-in customers, their ability to operate without any of the high overheads of traditional restaurants makes for a compelling proposition.

On the right side:

GLOBAL ONLINE FOOD DELIVERY MARKET

$35bn
Current total value

20%
Annual growth rate

$365bn
Projected value by 2030

$940m
SoftBank investment in driverless delivery start-up Nuro

Source: UBS: Is the Kitchen Dead?
MAPIC FOOD: In your view, how can dark kitchens help create a new operating model for food players?
SF: One of the biggest areas we’re focusing on is how we can help restaurants of all sizes turn data and insights into new business models and incremental revenue opportunities. For example, using our data we can identify geographical ‘selection gaps’ - where demand for a particular cuisine is in high demand but low supply. Using this insight, we can help existing restaurants which may have under-utilised kitchen space launch a ‘virtual restaurant’ that only exists in the digital world to plug this gap.

There is no physical storefront, no front-of-house, no customer-facing bricks and mortar presence, and you can only access the restaurant via a virtual storefront by app or website.

This is a win-win for restaurants and consumers. For a minimal incremental cost our restaurant partners can offer multiple menus and cuisines from the same real estate, maximising revenue opportunities and making their operations more efficient. At the same time, consumers get to enjoy more selection and food options.

MAPIC FOOD: What are the practical considerations?
SF: The great thing about virtual restaurants is there are very small start-up or expansion costs, you can test and experiment with the menu incredibly easily, with the feedback tools to continuously optimise the product-market fit.

For example, for most restaurants creating incremental revenue either means investing in physical expansion or physically increasing the capacity of real estate to serve more customers in-store, both of which traditionally come with a high cost/high-risk model. The great thing about virtual restaurants is that there is very little capital required to set up and very little impact on existing operations, with minimal risk if things don’t work out. You can move from concept to market very easily.

MAPIC FOOD: What are the key drivers for success?
SF: The two key ingredients for success are insights to identify ‘selection gaps’ and the right location to serve this with a virtual restaurant. We can help with both. For example, in France we identified poke as one of the most popular cuisine types - there was a 700% increase in orders for poke [a Hawaiian fish and rice bowl] between 2017 and 2018.

While increasingly popular, poke was a vastly under-served cuisine. In fact, poke was only available from a handful of restaurants in a small number of locations - a clear selection gap on the Uber Eats app.

Using this data, we developed Maison Poke as a new, multi-site virtual restaurant. Cote Sushi was identified as production-partner and is now serving the Maison Poke menu in 35 locations across France, and initial results are showing strong growth in incremental revenue for its parent business.

MAPIC FOOD: What are the key advances in payment?
SF: Our mission is to make eating effortless, everywhere for everyone. We must allow people to pay in a way that suits their lifestyle. While we have traditionally over-indexed on credit and debit card payments, we are now experimenting with various payment methods such as cash, meal vouchers, local debit card methods like iDEAL and even Apple Pay.
Dark kitchens are a property play, because where delivery is added to an existing restaurant then the costs already exist,” points out Peter Backman, UK-based restaurant consultant, differentiating between those restaurants that build up their delivery and those that start from ‘dark’ premises.

Ajay Lkahwani, VP special projects, Deliveroo, adds: “Delivery-only kitchens can significantly help restaurants grow their business by providing a very low-risk expansion platform for restaurants as we cover rent, capex, equipment costs and other operating expenses such as utility costs, site operations costs, cleaning, etc. We are effectively asking restaurants to handle the cooking and focus on offering their great products to customers without having to worry about additional costs and the operational complexities of running a regular restaurant.

“In addition, Deliveroo supports Editions restaurants to grow their business by working very closely with our partners and developing specific growth plans - marketing support, development of new concepts and brands, improving their cost structure and pricing, etc. Restaurants use our Editions kitchens to improve capacity-related challenges they are facing due to the increase of delivery orders in their regular sites, and to test new markets and concepts at very limited risk.”

“We are effectively asking restaurants to handle the cooking and focus on offering their great products to customers”  
Ajay Lkahwani, Deliveroo

“I think the sales level achievable currently means the unit economic model only works for established brands”  
Dan Houghton, Chilango

Dan Houghton, Co-CEO of UK-based Mexican restaurant chain Chilango, adds: “Optimisation [of dark kitchens] is about testing new catchment areas with low risk, especially infill in cities where the brand is known. It’s also about testing variants of menus, or new ‘virtual’ brands with adjacency to the operator’s existing expertise. Dark kitchens can also reduce rent and overheads but I think the sales level achievable currently means the unit economic model only works for established brands, and even then it’s still a lot of work for a relatively small upside. They do also act as an easy way for street food vendors to practice cooking at more scale. This is particularly appealing if they can double up their prep kitchen as a delivery kitchen, for B2C as well as B2B [catering], as this drops their breakeven for the new venture, considerably.”
From a restaurant’s perspective, success ultimately comes down to generating significant revenue out of these kitchens,” says Ajay Lkahwani, VP special projects, Deliveroo. “The key driver behind success is ultimately reaching product-market-fit in the catchment area a restaurant operates in, in other words, making sure that there is strong demand for a restaurant’s offering. Strong partners accomplish this by focusing on food quality, operational excellence – that is being able to keep up with the demand – and, most importantly, designing the right menus in terms of both price and food items. Partners have a unique opportunity to test and learn on an ongoing basis until they find an offering that has a really strong appeal.”

Dan Houghton, Co-CEO, Chilango, adds: “In the longer term, as the delivery market doubles or triples in size, there’s potential for established brands to roll-out nationally or internationally with third party kitchens such as Deliveroo Editions, Cloud Kitchens/FoodStars, etc but right now this is just a place holder in a pitch deck, and I think we may be five-10 years away from this. The property world moves slowly, especially when coupled with planning/zoning issues. This is not what people want to hear of course!

“There are four key drivers. Firstly, multi-channel: being on all delivery platforms, since the volumes are still low, it doesn’t make sense to restrict your distribution, Secondly, multi-use: several brands in one kitchen, or the kitchen doubles up as prep/catering. Thirdly, existing brand with high street presence: Domino’s has been at this for years, and could never make dark kitchens work...now the benefit of having a frontage might be changing, but I think the brand is still required. Finally, speed and accuracy: true of any food delivery service.”

Oscar Pierre, CEO of Paris delivery service Glovo, says that with online food delivery expected to keep growing at 15%-20% year-on-year for the next 10 years, it is “inevitable” that most of this food delivery will be cooked in dark kitchens for quality, margins and volume reasons.

“First, users will become more demanding with their food delivered at home. Restaurants will need to adapt their operations, for example preparation times are very short, food heat is well retained,” he says. “Second, the margins in dark kitchens are higher due to lower real state and staff costs. Finally, volume. We are seeing how some partners with Glovo have decided to launch a dark kitchen for capacity issues on weekend nights. This will happen with all successful delivery restaurants in the city.

“From what we’ve seen, the menu needs to be short - 15 items maximum - as most of the orders are placed in a smartphone screen. Second, you need to make sure that all dishes offered will
travel well inside a courier’s backpack and retain temperature well, not be very sensitive to vibrations, etc. Timing is very important, people want their food in less than 30 minutes and for that, the restaurant needs to operate like clockwork so that it coordinates with the courier arrival time. Finally, being data-driven is extremely important. Platforms like Glovo do provide a lot of insights from the customers’ reviews, and the best performing restaurants are those that iterate their operations and menus quickly based on it.”

Damien Bon, CEO of European eco-courier Stuart, believes that what he describes as a “fundamental shift” in foodservice operations brings two challenges for restaurants.

“Firstly, customer seating and waiting areas become more and more under-used or even vacant, putting restaurant profitability under pressure; secondly, serving customers while preparing food to be delivered - at the same peak hour of the day - sometimes means deteriorating customer experience, with longer delivery times,” he says. “Hence the need to industrialise home delivery to reduce overheads, for example rent costs, while simultaneously improving delivery times - with ultimately clear benefits for the client and restaurant efficiency.”

“**You need to make sure that all dishes offered will travel well inside a courier’s backpack and retain temperature well**”

*Oscar Pierre, Glovo*
One of the biggest changes with the expansion of delivery platforms is that the power of communication and branding has, in many cases, switched from the operator to the delivery business. While these aggregated platforms provide a powerful new revenue stream for operators, they do not come without risk.

“For the delivery companies there is a growing opportunity to build profits through the service and increasingly through the relationship, because the problem for the restaurant is that the customer relationship is no longer between them and the consumer but between the delivery company and the consumer,” says Peter Backman, UK-based restaurant consultant. “It may be that the customer chooses their cuisine based on their user experience with the app and what restaurants it services and what it promotes.

“In some cases, it is the delivery companies which are pushing the agenda, for example Deliveroo might identify that a certain catchment lacks a type of cuisine – say noodles - and encourage an operator to fulfil that demand.”

However, Damien Bon, CEO of Stuart, says: “There are several drivers to succeed, all around efficiency and adapting to client needs: hosting different cuisines in the same location, sharing ingredients across different brands and products, pooling deliveries, anticipating client demand in a certain location and time of the day - first choosing the right kitchen location - or adapting quickly menus to market trends.

“By hosting different cuisines in the same location, you can - to the extent you serve cold dishes - mutualise couriers across different clients in the same neighbourhood. It then means reducing the unit cost per delivery. That’s what we do really well at Stuart for food players across different locations, whether dark kitchens or bricks-and-mortar restaurants. Finally, the ability for dark kitchens to operate without overheads implies a greater capacity to absorb the delivery cost.”

From Deliveroo’s perspective, success ultimately means providing our customers with the best possible selection at the right price and the right service (speed, overall customer experience), says Ajay Lkahwani, VP special projects, Deliveroo. “When we succeed from a selection, service and price perspective, that allows us

“The ability for dark kitchens to operate without overheads implies a greater capacity to absorb the delivery cost”

Damien Bon, Stuart
to scale significantly and also accomplish our financial goals. In addition, Editions also looks after our sites’ operations on a day-to-day basis, so it is also critical for us to operate sites with the highest possible quality standards and ensure that all our kitchens are compliant and highly rated,” he says.

“We are there to serve all customer needs when it comes to food and we therefore see a compelling proposition in bringing food cuisines and brands to as many customers as we can. We therefore focus on inputs of selection and service levels and aim to make profits in the mid to long term through increase in order volumes, operational efficiencies, automation and trust from our consumers and restaurant partners. The vast majority of our transactions are app-based payments, although Deliveroo recently also started accepting cash in a few of our markets, such as Dubai, to expand payment options for our customers.”

Dan Houghton, Co-CEO, Chilango, adds: “My advice would be, don’t do logistics yourself. Courier utilisation is the key. Vertical integration has a bad track record recently. You also need to price higher on delivery. If you don’t you are subsidising your walk-in customers to switch to a lower margin channel. Delivery partners like price parity with walk-in, but can’t demand it as this is price fixing. Ask your delivery partner – such as Deliveroo or UberEats - for the anonymised postcode data of your customers. You can infer a great deal from this. Also, ask your delivery partner to test with a larger radius, and see what you can learn. These far-away customers may not reorder as often - speed is important after all - but you can get a sense where the demand lies.”

And Oscar Pierre, CEO, Glovo, points out that food delivery, if well executed, brings better margins for the restaurant. “Apart from the lower real estate and staff costs, food delivery demand is usually a lot more concentrated in a few dishes and therefore more predictable, with less wastage,” he says. “Due to simpler menus and dishes in food delivery than in restaurants, we will see cooking ‘robotisation’ very soon, lowering costs even more.”

However, Backman adds a word of caution: “Dark kitchens are not all good. For operators, delivery commissions can be anywhere from 15-50% and the growth in delivery also favours those restaurants where the cuisine travels better. For the delivery companies, they are currently valued as technology businesses but it could be argued that they should be valued as low margin delivery models. That would impact their valuations heavily. Operators with restaurants also need to be careful that they don’t allow delivery to take over their stores, impacting the in-restaurant experience for diners. There are strategies for this, such as separate doors and areas for delivery.

“There is a lot of change going on as the market settles down”

Peter Backman, restaurant consultant

Millennials are three times as likely to order food delivery than their parents

Glovo predicts annual delivery growth of up to 20%