# Restaurant Delivery: Are the "ODP" the Industry's "OTA"? Part I & II

By Christopher Muller

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# Part I



The entire restaurant industry, from the simplest quick service joint to the most complex fine dining jewel, is caught in a veritable frenzy of delivery.  It may be, unfortunately, a very risky path to travel for the uninitiated restaurant operation, but delivery is driving the investment community to a fever pitch. [1] We have entered into the time of the restaurant On-Line Delivery Provider (ODP) which mirrors in many ways the On-Line Travel Agent (OTA) which has so disrupted the lodging industry.

In two complimentary BHR articles here, we present a look at the 8 different models of restaurant delivery and how they are affecting both senior management and customer choices.

## A Quick Lesson From Pricing History

For observers of the global Hospitality Industry this should send up warning flags.  In a galaxy far, far away, the Lodging industry managed revenues by using simple seasonal or attribute pricing models (On-, Shoulder- and Off-Peak rates, or premiums for "A Room With A View") and sold some limited excess inventory through a network of independent Travel Agents (at an onerous 10% commission!).

Then, as the Internet expanded, and the travel market imploded after the 9-11 tragedy, a new and exciting model emerged - the On-Line Travel Agent (OTA) acting as a third party aggregator appeared.  Hotel companies willingly gave open access to all of their unsold room inventory to the OTAs (Expedia, Travelocity, Priceline, Booking.com,

Kayak, Trivago, etc.) to sell directly at deep discounts, often between 25 and 30% off posted Rack Rates. Occupancies rose, but Average Daily Rates plummeted, and profits quickly diminished. Hotels, relying on the old pricing models were caught competing "with themselves" and watched as formerly loyal customers switched their buying habits and loyalties to the OTA that gave them the best rate. Customers could scroll through pages of prices, often for the exact same room in the same hotel, searching for the cheapest rate. Hotel rooms, instead of being unique destinations became interchangeable commodities.

It has taken almost twenty years, but through brand consolidation and a total system-wide transformation into a Revenue Management based pricing model, the hotel business has been transformed and the OTAs are being aggressively challenged for dominance. This should be a lesson for the restaurant owner/operator, the OTAs drove nothing but price as a decision attribute, the ODPs are poised to do the same thing with both price and convenience, unfortunately restaurants probably won't have decades to recover.

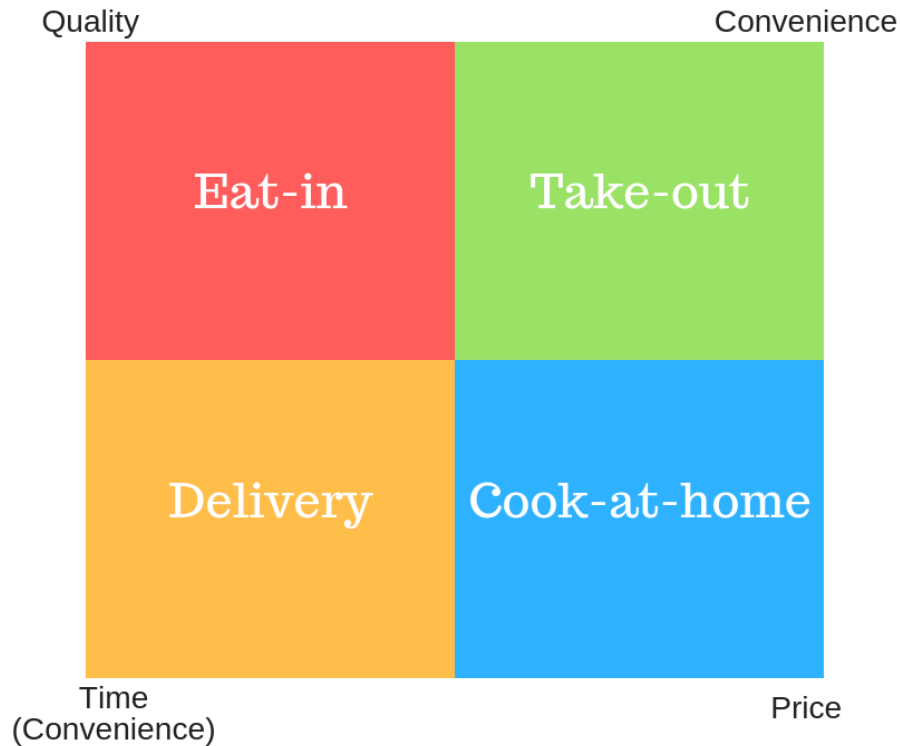**Today's Restaurant Delivery Frenzy –The Rise of the ODP**

Whether it's the savvy but shape-shifting Millennial, the rapidly aging Baby Boomer, or the rising young digital native from the i-Generation, it seems that customers in all shapes and sizes just want to have their meals brought to them at home, the office, or somewhere in between. Breaking the code of the delivery model—becoming the customer's choice of who serves up breakfast, lunch or dinner at home, work or play—has emerged as the Holy Grail of the foodservice business. But it may be more like the other mythic Dark Ages metaphor, the Plague, potentially killing upwards of 30% of existing restaurant units.

So, what exactly is "delivery" today, how did it evolve into such a big, expanding component of the restaurant offering and what are the implications going forward for the industry? Just how do the On-Line Delivery Providers, the ODP, dominate the market?

We can begin by agreeing that delivery is a distinct and rapidly growing distribution channel, although it has been around in one form or another for a very long time. And while not exactly a new technology, nor necessarily a profitable one, the exploding market for the delivery of food is poised for an inevitable shake out as it quickly approaches a mature phase consolidation.[2]

In late 2018 delivery is all about instant gratification, not just for the diner but some would suggest for the restaurant as well. At first glance, it all feels so simple and easy. But like so much in restaurant management, there is more than one way to get something done, even the simplest of things.

# The Four Food Service Distribution Channels

Quality                 Convenience

| | |
|---|---|
| Eat-in | Take-out |
| Delivery | Cook-at-home |

Time
(Convenience)              Price

## Emerging Key Success Factors

Like so many emerging business models in the on-line digital age, food delivery is developing its own metrics and factors to be considered and mastered. While still evolving, among these now are:

- Addressing the profit challenges of "The Last Mile" in the delivery chain

- Minimizing the high cost of Customer Acquisition

- Developing an integrated APP, website, tablet and smartphone ordering platform

- Designing the most effective delivery driver fleet system

- Establishing an attractive and competitive user fee basis

- Creating positive and immediate Brand recognition

- Building a proprietary Knowledge Base of data storage, analytics and access

Delivery of food, especially from a restaurant to a consumer, has become a multi-billion dollar segment of the industry. Some are predicting that it will overtake the traditional dine-in segment completely within a decade, although the complexity of getting it right and turning a profit while doing so, can still be elusive even for the largest players. And of course, no one should forget that Amazon is over in the corner waiting to see how things evolve in an online delivery world they basically invented.

**Traditional and Controlled**

As noted, the delivery of food from a restaurant directly to a local customer is not a new idea although traditionally the customer came to the restaurant and picked up or carried out their food order. Both delivery and carry-out were best suited to a restaurant with a simple, easily transported menu. Where a significant amount of the value of the meal was the dining experience and table service, meals to go were often comprised of a package of leftovers or the long gone term "doggie bags."

Here is a look at four models with some measure of control for restaurant owners and operators over the quality and profitability of their offerings.

## THE 8 MODELS

1. Independent - One Shot

2. Cloud Kitchens - Hub & Spoke

3. Ghost Kitchens

4. Virtual Restaurants

5. Aggregator ODP - No Fleet

6. Consolidator - Bulk Drop System

7. Aggregator ODP - Owned Fleet

8. Aggregator ODP - Dark Kitchen

## 1. The Independent - One Shot

As a service provider a restaurant may decide that in order to meet the needs of its local customer base it should provide a delivery option. At one time, only a few restaurants in an urban core would have delivery offers and these might typically be delicatessens or Chinese restaurants with few seats and a very strong focus on offering takeout options. The food can be cooked, boxed, wrapped and brought quickly to an office or apartment within a few blocks on foot or by bicycle.

This model is the most basic - a caller, the kitchen, and an employee bringing hot food directly to the customer. The restaurant controls the quality, manages the relationship with the diner and absorbs the full cost and all the revenues. It typically comes with higher operating costs for labor (primarily from an in-house paid delivery driver fleet) and with premium rent from the need for an attractive customer-facing retail space. On

the plus side, all local customer information may be controlled by the restaurant and there are no fees to share with an outside third-party service.

But as the independent operator reaches for the brass ring on the delivery merry-go-round, they also need to be careful not to lose their grip on their existing ride. A new distribution channel can be much more challenging that just taking a customer order. As noted by Jennifer Marston:

> …restaurants are under pressure to adapt…More and more, that means altering the physical restaurant space so it can better accommodate this influx of new orders. Extra meals require extra bodies to cook and package the food, after all, not to mention extra space for third-party devices, and somewhere to put completed orders waiting to be picked up by a delivery driver.[3]

An interesting twist on this single restaurant model of trying to find a way to both control and expand the delivery system while maintaining some measure of profitability is one recently proposed in the restaurant trade magazine Restaurant Business Online:

> He (CMO Nabeel Alamgir) explained that Bareburger is already striving to convert customers ordering through **third parties' apps** into users of the chain's own channels. Patrons of an Uber Eats or Postmates might be offered a 10% discount on their next order if it's placed through Bareburger's website. The chain can afford a discount that deep because the financial impact is still less than the 20% or 30% discount an outside service typically charges.

> Alamgir noted at the start of the panel's presentation that a service started by restaurants for restaurants would have been an attractive alternative to some of the third-party giants. "Let's make our own platform. Let's make our own Grubhub," he said.[4]

## 2. The Cloud Kitchen - A Hub & Spoke System

It can be argued that today's focused delivery channel began in earnest when Domino's offered up a "30 Minute or Free" guarantee in 1973. In order to make this guarantee effective, the company created a hub and spoke system, in effect building a series of franchised units in low cost locations. They were characterized by being geographically market-centered but with no need for a "High Street" customer facing address. This was directly in contrast to the overwhelming market advantage owned by Pizza Hut and its network of "Red Roof" full service pizzerias with their focus on dine-in and takeout service. But the competitive advantage that came from having units with no dine-in, limited customer carry-out, and which were serviced by a central commissary set in motion the shift away from the traditional eat-in model.

> "The reality is, when the red roof restaurant was created, the idea of delivery wasn't part of the concept," said Pizza Hut chief executive David Gibbs, a 26-year veteran at parent company Yum Brands..."so in many cases, our business has outgrown the capabilities of those restaurants..."[5]

Now, four decades later Domino's is the world leader in delivery, pizza or otherwise. It has done this by controlling the entire process or what is called the "full stack" in the delivery cycle. Now describing itself as an IT and logistics company that sells pizza, the backbone of the system is that they control the customer ordering process, the production quality process, and through a vast franchise network the delivery process.

Next to come, using new GPS and AI technologies, Domino's predicts that it will be able to make deliveries not just to a formal building address, but to anywhere a customer can be located by tracking their cellphone, even if that is a park bench or a blanket on the beach.

But Domino's is not the only leader to be expanding its Cloud Kitchen delivery system. Already designed on a commissary production system model, giant fast casual leader, Panera Bread, tested delivery in Boston and then announced an expansion across the United States in early May, 2018 with a system based upon using its own delivery drivers. [6] Following the trend in October the largest chicken sandwich chain, Chick-fil-A, announced it was beginning to test the hub and spoke model of delivery in Nashville, TN and Louisville, KY.

> Chick-fil-A is opening two new restaurants that don't have something you commonly associate with the chain: seats.

> Chick-fil-A, the Atlanta-based chicken sandwich chain, is testing catering and delivery locations in Nashville and Louisville, Ky., that will open this month.

> The locations, according to an announcement on the chain's website, have no dining rooms or drive thru's and are designed to be hubs for catering and delivery orders. The restaurants will not accept cash, either.[7]

The Cloud Kitchen model can be very effective for restaurant companies with large enough scale, whether in a single city or across a region, to take advantage of a single production kitchen site with remote staging kitchens. Ultimately the "full stack" control from order to front door can come from as few as three restaurants or as many as 3000.

This also means that the foundation is laid for vast proprietary customer data collection and eventually data mining by the most forward-looking operators.

It can be argued that the Food Truck movement of the past decade is a subset of the Cloud Kitchen model.  By most local health code laws, food trucks must have a "home kitchen" or commissary for their bulk production that meets all health and sanitation code requirements.  In many urban centers, to be successful a food truck company needs to have multiple trucks on the road acting as a distribution network.  While this is also a classic Hub & Spoke model, it comes with similarities to a model in the next article, **#6 The Consolidator**, with distribution on a bus stop route and not a one-to-one last mile taxi route.



## 3. The Ghost Kitchen

One further refinement of the Cloud Kitchen is the Ghost Kitchen.  As delivery becomes more of a threat to the traditional dine-in restaurant option, some suggest that this model, in fact, is the future of restaurants—basically a highly efficient hybrid of menu concepts, specialized production and logistics, and low labor cost with no eat-in customers.

In that way, this model is identified by three key components.

First, it removes the dining room or takeout from the restaurant completely, working out of a kitchen whose location is based on nearness to its core customer market yet in a typically low rent out-of-the-way space.

Second, it does not hire any paid employees to deliver, instead making use (through partnership or agreement) of the many third-party delivery companies like GrubHub, Postmates or Doordash.

Third, and possibly the most important, because of the flexibility of only needing an APP, website or traditional telephone ordering system, more than one cuisine can be produced in the same kitchen space. Easy to prepare, cook and deliver foods such as salads, sandwiches, Asian and other ethnic dishes, or gourmet pizza can all be offered while cross-utilizing similar ingredients in creative menu offerings.[8]

This can best be described as an "order only" restaurant. The most prominent or well-known of these Ghost Kitchens would be Green Summit (see transition to #8 Dark Kitchen in Part 2). While garnering a good amount of press, the celebrity chef David Chang's Maple, closed its operation in 2017 with some assets moving to London and the delivery company Deliveroo.[9] Chef Chang sold the physical kitchen space, Ando, to Uber Eats after ceasing operations in January, 2018. [10]

Because no customer ever sets foot through the front door the owners can put all of their investment in kitchen equipment and the technology of ordering. A Ghost Kitchen offers customers large menu choices, and just as its cousin the Cloud Kitchen, has the option to keep track of its own proprietary customer data set through the direct ordering process. The tradeoff is that ownership sacrifices the customer interface at delivery of the Cloud Kitchen model. Operating and start-up costs are low and efficiency can be very high. The risk is that a large portion of the margin (sometimes up to 30%) from market-driven menu prices is taken by the delivery partnership, who also control the brand image when customers receive their orders off-site.[11]

## 4. Virtual Restaurants

Along with disrupting the taxi business, Uber Eats is about to globally disrupt the restaurant delivery business. As of October, 2018, Uber Eats had over 1600 "virtual restaurants" around the globe, with almost 1000 in its US partnership portfolio. The majority of these are not the Cloud or Dark Kitchen models mentioned above, but are existing restaurants with new brands that only exist through Uber Eats. This model, while charging very high fees to the restaurant, allows them to technically not compete with themselves in the home delivery marketplace. Uber Eats gains more menus to offer, and limits any need for an investment in a commissary space.

> For SushiYaa, Kim says the virtual restaurant concept has been transformative. "Because this concept worked so well for us, we actually changed one of our restaurants from a sushi buffet concept to a regular restaurant with 8 different virtual restaurant brands inside it. The buffet sales weren't doing so well and the delivery side was doing better, so we thought — let's change it completely so we're focused more on delivery." From a sales standpoint, he says it's "almost as if we have another restaurant without paying additional rent and labor, even though [Uber Eats] takes about 30 percent."[12]

One other type of Virtual Kitchen involves the licensing of existing restaurant recipes and menu items in a curated virtual model. The start-up concept Good Uncle is using this to compete in the university meal plan segment, offering a range of pricing options

for higher quality prepared meals, delivered by their own delivery fleet using the bus stop common drop off method.  This is a limited menu, limited target market, which benefits from a direct marketing approach, lower operating costs, and uses both a subscription and premium fee based pricing system.[13] It is a Virtual Kitchen because there is no restaurant or other customer facing facility, it exists only online.

## Part One - Conclusions

Delivery models, some traditional, some evolving, offer many opportunities for restaurant operators, especially those in the QSR and Fast Casual segments, where speed and price and convenience are the drivers of consumer choice.

The challenge in today's delivery market is how owners and operators can maintain both high quality and long-term profitability in the products/services they offer.  For many meals, the time and distance from kitchen to table can be more than 30 minutes or multiple miles. Quality of presentation and flavor may quickly diminish.  More importantly, where the medium annual profitability for restaurants across all segments in the USA is considerably less than 10%, losing up to 30% of top line revenues is not a path to a successful future, (even if total sales increase by 20%).

# Part II



In Part 1 of this analysis of the restaurant delivery system we looked at the owner/operator models which still offer some measure of control over price and quality. This is fast becoming an issue with the rise of the Ghost Kitchen where the ODP is an integral part of the equation. Here we present the larger challenges from the dominant ODP control of the marketplace. It is good to remember that most of the ODPs themselves are still looking to find profits in what they do, a suggestion that those profits will need to come at the expense of the restaurant providers in one way or another.

## 5. The Aggregator or On-Line Delivery Provider (ODP) - No Driver Fleet

If someone were to say, "Let me take care of all of your delivery problems for a small cut of your revenues" many restaurant operators, especially those eager to get into the market with the least amount of upfront investment, would jump at the chance. Enter the On-Line Delivery Provider with a business model built upon a brand name customer-facing APP, website or phone number and an enormous amount of back office computing power to drive order volume.

At its core, to be successful the Aggregator needs to be a world-class matchmaker for food orders, with both a large customer database of users and a broad assortment of restaurant menus offered in major cities. Like many of what MIT's Bill Aulet calls an Innovation Driven Enterprise (IDE)[13] the cost of customer acquisition is the key hurdle in entering this distribution channel. What it doesn't need is its own fleet of

employee delivery drivers. Capitalizing on the DIY gig economy, drivers are hired on a contractual basis, working as independent delivery agents with their own vehicles.

The barrier to lowering this high cost of entry has favored early market entrants and large well-funded digital innovators. Worldwide, the fastest growing ODP is Uber Eats, the natural extension of car service provider, Uber, with its existing enormous data base of users, an ever expanding fleet of drivers, and the understanding for a driver that delivering food with an APP-based pre-payment system is considerably faster and easier than dealing with human passengers.

The upside for restaurant companies using an ODP such as Uber Eats, from those as dominant as McDonalds or as small as the local pizzeria, is that there is no need to hire and train non-core employees. As touted by Uber Eats delivery service can begin almost immediately upon signing up. The downside, that has a potential for long term impact, is two-fold. The fee structure for traditionally low margin restaurants can be between 20-30% of a menu item price, leaving little to cover remaining expenses. Worse though is that the restaurant gives away its brand and trade dress image to the company making the delivery to the front door. McDonalds hamburgers may be in the bag, but the name on the ordering APP and the uniform on the person handing it to the customer says Uber Eats.



## 6. The Consolidator - Bulk "Bus Stop"

As noted, the most expensive single piece of the delivery puzzle is getting food from the restaurant to the front door, what is called "the last mile." One proven way to minimize that expense is to have the customer meet the food delivery at a central drop-off spot (see: Amazon [14]). A start-up, Yun Ban Bao, in New York City is taking advantage of

ethnic Chinese food deserts through direct targeted marketing using the dominant Chinese online service provider, WeChat.  By doing so it is creating a captive delivery market with the advantage of pre-ordering and payment.[15]

Taking online requests for delivery on the next business day, then consolidating orders using a bulk delivery model, Yun Ban Bao is lowering the cost of delivery while maintaining control with its own fleet of drivers.  It advertises a data analytics service for smaller restaurants as well as being a revenue growth accelerator for restaurants in suburban locations which otherwise could not find new or broader market opportunities.

Using a pre-arranged group delivery network, often outside parks, office towers or apartment buildings, the system mirrors a bus route, not the more traditional taxi route model of one-on-one delivery.  This also affords the network of restaurants a way to lower operating costs by controlling the production process in advance.

## 7. The Aggregator ODP - Owned Fleet

Some of the largest ODP players started in the delivery business by controlling their own fleets of employee managed delivery drivers.  The global leader, Just Eat,[16] has used this model throughout the UK, Europe and worldwide.  But it also has worked directly with restaurants who have their own in-house deliver fleets to create a broad partnership.  Just Eat acts as the online ordering platform, but then allows the local branded company to be the face at the door.

The ability to present a standardized customer facing brand identity means that trust may be established with the customer directly.  While this can come at the risk of the restaurant losing its direct brand relationship, what Just Eat has been able to master is the collection of a vast customer database of its users.  It has created a relationship with many of its restaurant partners to assist them in finding ideal store locations, menu item design and creative targeted pricing and promotions programs which would not otherwise be affordable or even available to smaller companies.

For these ODP companies, the costs for maintaining their own fleets or working as a hybrid with a local restaurant creates a higher operating expense, but these are often offset with a higher fee share from both the restaurant and the consumer.  It also creates a competitive advantage by building a broader network of restaurants to choose from for the customer, which builds long term loyalty and habitual purchase behaviors.

## 8. The ODP Aggregator - Dark Kitchens

One of the greatest threats to the bricks and mortar restaurant delivery partners is the emerging concept of a Dark Kitchen.  This is a space created by an OPD to facilitate the lowest cost per delivery mile from restaurant kitchen to the highest density of users.  While this is similar to the Cloud Kitchen model, in this case the OPD establishes a cluster of small dedicated but competitive restaurant kitchens in a single site.  A Dark Kitchen is also similar to the trending food hall concept, but comes with no direct customer interaction—no walk-in guest visits these production facilities.  In the UK this was pioneered by Deliveroo with its urban RooBox or Editions concepts.[17] Partner restaurants rent portable kitchen space from the delivery service and pay a larger percentage fee to cover the build-out costs for their space.  Restaurants staff the kitchens at their own expense, as well.

Earlier this year, Grubhub invested $1 million in Green Summit Group (see Ghost Kitchen in Part I), a startup with nine virtual restaurants operating from a single kitchen. DoorDash is renting extra space from the Santa Clara Fairgrounds in San Jose, Calif., and making it available to foodservice operators who want to create delivery-only options. In Los Angeles, Postmates leased a commissary kitchen space so its restaurants can reach new customers. And UberEATS is exploring the concept with Poke Café in Chicago — a virtual restaurant serving Hawaiian poke bowls.

> "We can work with existing restaurant partners to create delivery-only menus. (They would) appear as entirely new restaurants on the UberEats app," Ambika Krishnamachar, UberEats product manager, said in an article on Mashable.[18]

And again, while on its face this appears to be a positive opportunity for independent or chain restaurants to lower costs or disaggregate the dine-in from the delivery production process, it is not cost free.  In fact, as a logical progression would suggest, the OPD Deliveroo service has realized that the actual local restaurant in this mix is not a necessity for success.  Instead by using its own "innovation fund" it will to go directly into the restaurant business itself, creating "from scratch" concepts by working with celebrity chefs and data mining information from its enormous customer data base. [19]

As more of the OPDs look to find profits to pass along to the aggressive investors who have funded rapid growth, they will inevitably look to cut out the middleman and provide meals themselves to increase margins. The kitchen that may actually go "dark" is the local one on the corner down the street in an independent restaurant.

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## Conclusions

This is undoubtedly both an interesting and a challenging time for the restaurant industry and the Online Delivery Providers who are feeding from it.  Neither side seems to have figured out how to make the new consumer demand for off-site delivery work to their complete advantage.

It is impossible to believe that any restaurant can survive if it gives away up to 30% of its top line revenues when the average net profit is less than 10%.  No amount of increased

volume in sales will make up for that.  As Cameron Keng wrote in his column "Why Uber Eats Will Eat You Into Bankruptcy" in March, 2018:

> Based on the average profit margins above, every restaurant that engages Uber Eats will lose money on every order they take. The more orders coming from Uber Eats, the more money a restaurant would lose.[20]

At the same time, while it is hard to get exact information, it appears that almost none of the largest On-Line Delivery Providers, in any of the described segments is actually showing a profit.  Uber Eats is only profitable in 27 of its more than 100 urban markets,[21] and while Deliveroo's sales rose in 2017 to £277 million ($356 million), the company lost an astounding £185 million ($237 million).[22]  Yet Uber Eats is offering over $2 billion to purchase/merge with Deliveroo.

Finally, as Jonathan Maze wrote in his Bottom Line column in early October the restaurant industry is simply unprepared for what appears to be a tectonic shift in traditional restaurant segments, consumer behavior, labor utilization, Real Estate valuation and investor interest.

> If delivery is the future of the restaurant business, the restaurant business as it is currently constructed is in trouble.

> The service is growing rapidly. But it's increasingly replacing existing restaurant business rather than taking business away from grocers or other food retailers. [23]

As we noted in the beginning, it took the lodging industry almost 20 years to begin to make this kind of tectonic change and it is nowhere near complete.  A few very large hotel companies, through merger and acquisition, have consolidated enough power to start the move away from handing over all of their pricing to the OTA's.  In economic terms, hotel companies are trying to go from being Price Takers to Price Setters.

At this early stage of the restaurant OPD's domination of the delivery cycle, it is not clear that any restaurant organization is large enough to break the fever, especially now that McDonald's is partnering with Uber Eats.  While it may appear that the On-line Delivery Provider is a restaurant's partner, friend or even savior, it is none of those.  In fact, in order to become profitable the OPD is looking to become a direct competitor.

What is certain is that few restaurant companies, and certainly no independent operations, can survive the next two decades letting third parties dictate what convenience and price mean.  In fact, this might be a good time to get out of the house and go visit your favorite local restaurant.  Sacrificing some convenience for a great experience is a good value and that restaurant may not be around the next time you want to show up.

Christopher C. Muller is Professor of the Practice of Hospitality Administration and former Dean of the School of Hospitality Administration at Boston University. Each year, he moderates the European Food Service Summit, a major conference for restaurant and supply executives. He holds a bachelor's degree in political science from Hobart College and two graduate degrees from Cornell University, including a Ph.D. in hospitality administration. Email: cmuller@bu.edu

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