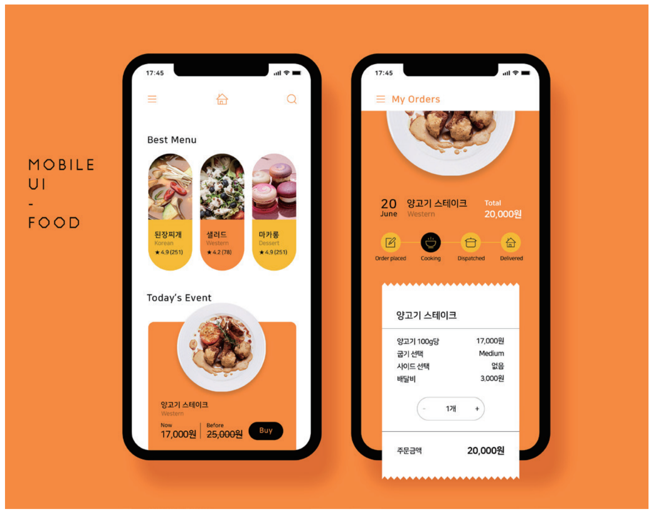
The New Age Digital Landlords

Broken Model

The recent pandemic has accelerated trends in the marketplace that were already apparent around the world, namely the use of technology platforms for purchasing convenience. We all know about cashless payments, curbside pick-up and delivery models & new ordering platforms through social media messaging services, etc. Full service restaurants that never needed to worry about anything other than dine-in customers suddenly found themselves in a struggle for survival to connect to these same customers with contactless services. While obviously not the best avenue for delivering high standards of hospitably, restaurants did whatever they needed to do to keep the doors open and pay the rent.

Over the past several years, we have witnessed the growth of restaurant delivery platforms with financial valuations in the stratosphere. Young tech savvy entrepreneurs discovered that it was far more lucrative to build a technology platform than cook food. In other words, food-tech was far more profitable than the restaurant business itself. The only problem was that none of these platforms were profitable, and while investors piled in to multiple fund-raising series offered up by clever investment bankers hoping for an IPO so they could sell their shares to bigger fools, there may not be an exit for these investors in the covid-19 era, at least in the short term. These "unicorns" are now cutting headcounts and looking for many ways to conserve their cash and slash their burn rates. Just look at the Softbank Vision Fund's latest developments.

Meanwhile, there has been a growing rebellion to these services because it is not profitable to the restaurant either. Fees by these companies can range from 20-40% depending on the region and type of client. For example, the large chains get the best rates(around 20% in the USA), but the independents are charged 30%+ so they in effect subsidize the big guys.



Independents can pay even higher fees if they want to be featured prominently on the platform's app, similar to a stocking fee at a big box retailer. Adding insult to injury, local governments in cities like New York and San Francisco are passing laws capping delivery fees to no more than 10~15%, a new form of rent control.

This unprofitable delivery model, hated by the merchants and governments alike, is now a worldwide phenomenon and there are no good solutions in sight to fix it. The most obvious trend now is industry consolidation to reduce the number of competitors so the platforms can cut costs, be more productive and possibly raise prices given fewer competitors. The recently announced merger talks between Uber Eats & Grubhub is just the latest development. This all suggests that restaurants are likely to experience more pain not less in the future.

Rents in Asia tend to be at least twice as high as a percentage of sales compared to the USA, so in the beginning delivery platforms looked like a good way to increase marginal profits with the same fixed rent and labor costs. However, it is not always clear that these delivery sales are incremental and with so many restaurants on these platforms, it is entirely possible that it is more of a zero-sum game for everyone.

These delivery and take-away platforms have become the "new age digital landlords." Whether renting a physical space or joining a tech platform, the restaurant owner is still paying high tenancy costs.

There are delivery platforms that currently are profitable and have been so for many years – the large pizza chains. Their main difference with the new delivery platforms is that they only delivery their own food by themselves with their own technology using the same smart phones.

Another platform gaining traction in parts of the USA is a co-op model whereby many restaurants join together to do their own delivery. I have seen several of these models and they can be very beneficial to the restaurant owners with much lower commissions and can actually generate financial paybacks to the co-op members in the form of dividends.

No matter which model is sustainable in the future, the technology itself is not the obstacle to profitability. There are plenty of cheap solutions available now off the shelf. Delivery was becoming more and more popular before covid-19 and the current pandemic just accelerated recent trends. I think the best solutions will eventually come from restaurant owners themselves, not from tech entrepreneurs. In my view, all the major restaurant platforms around the world are severely over-valued and a big reckoning is coming soon for the investors. This is a broken model that cannot be fixed easily.