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Soggy Fries vs. Sagging Profits: Restaurants Face Delivery Dilemma

Dining chains question whether apps like UberEats and DoorDash make economic sense as consumers demand at-home options



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By

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Ever eat a french fry that's been carted across town? By the time you bite into it, that fry has morphed into a cold, limp, greasy wedge that takes some courage to swallow.

Business models, much like french fries, don't always travel well. This is a lesson the restaurant business is learning as eateries struggle to draw diners through the door or the drive-through and look to food-delivery apps to soothe the financial heartburn. Chains such as McDonald's are rushing to link up with the likes of UberEats, but we're learning McDelivery comes with a costly downside.

Startups with slick apps, armies of delivery people and names like DoorDash, Grubhub and [Postmates](#) offer quick and easy shopping for consumers who have stayed away from restaurants in droves even as the economy has rumbled upward from the wreckage of the financial crisis more than a decade ago. Nearly 80% of meals are now eaten at home, up from 75% a decade ago, according to numbers from market researcher NPD Group this week.

'We're not happy with the economics.'

—Darden Restaurants CEO Gene Lee, on the associated costs of third-party delivery

But these tech firms—[often valued by investors as high as major restaurant chains](#)—threaten to gobble up a disproportionate share of profits from the sales they broker. The companies often run lean, paying contract drivers using their own transportation, and charging both the restaurant and the patrons.

Restaurant owners face a choice: set up their own delivery team or contract with an outsider. The first option comes with more overhead at a time when low unemployment and rising minimum wages have increased labor costs. The second option also comes with a cost, however, the premium restaurants must pay to a third-party delivery service or app.

If a \$4 Big Mac is sent your way by DoorDash Inc., for instance, 80 cents [goes to the delivery service](#), according to DoorDash's model. That doesn't include DoorDash's charge to customers. McDonald's Corp. Chief Executive [Steve Easterbrook](#) told investors in October that delivery represents 10% of sales in some markets, boosting loyalty and incremental sales.

Restaurants may tout delivery as a "eureka moment," [Kurt Schnaubelt](#), a managing director with consultant AlixPartners, said, "but it's a strategy of hope."

Other than pizza parlors, specialty caterers and Chinese places, few others outside of tightly packed urban hubs have proven they can consistently make much money delivering, Mr. Schnaubelt said. He estimates delivery services can command as much as 40% of the revenue earned on a sale, leaving little for the owner of the kitchen that prepared the meal. Industry [pricing power has generally been weak](#) despite the broader economic upturn, so restaurants have struggled to pass delivery costs on to the buyer.

Some restaurant chain executives say they aren't convinced that delivering a \$10 meal makes economic or strategic sense. Darden Restaurants Inc. CEO [Gene Lee](#), who runs Olive Garden and other chains, has said partnerships with Silicon Valley delivery services force restaurants to fork over too much customer data and give up profits.

"We're not happy with the economics," Mr. Lee said during an [earnings conference call](#) a few months ago.

Even though an [overwhelming number of transactions take place in physical stores](#), few industries can ignore the Internet's influence on daily operations. Companies from grocery stores to jewelers have been forced to build e-commerce divisions to ward off Amazon.com and other online sellers.



While McDonald's has recently seen a decline in foot traffic at its stores, its chief recently said that delivery represents 10% of sales in some markets. Here, an UberEats delivery driver picks up an order at a McDonald's in La Palma, Calif. PHOTO: MARK RIGHTMIRE/ZUMA PRESS

The internet's impact on the restaurant business has been relatively muted but it's undeniable, according NPD's numbers. While delivery represented only 3% of all restaurant orders in 2018, that share is up 6% from 2017. Online ordering, including people picking it up themselves, increased 23% from the year before.

Most restaurant giants say they can't avoid the delivery trend. Dining-room visits have been slipping for years and remained flat in 2018, according to NPD. When chains try to raise prices, they pay for it in fewer customers coming through the doors.

At McDonald's, for instance, menu [prices increased 2%](#) in the fourth quarter, but the number of diners in its U.S. stores fell by about the same percentage. "People are typically eating out a little less often, and we respond to those sorts of trends with home delivery, for example," Mr. Easterbrook said in a conference call last month.

There are plenty of tactics chains are trying to increase the number of customers coming to their restaurants. McDonald's is looking at beefing up staffing levels during busy times or improving its coffee menu. White Castle, a closely held rival, last year introduced the [Impossible Slider](#)—a meatless burger that costs about a buck more than the chain's famed square of beef, for instance.

[Jamie Richardson](#), a White Castle spokesman, said this week it increased store traffic and brought in a different buyer than the [stereotypical customer jonesing for a late-night snack](#). Still, meatless options are only one example of the company's experimentation. It too is diving into delivery, having announced a Grubhub partnership last summer. Newsletter Sign-up

Measuring the financial result is still difficult, Mr. Richardson said, but the Columbus, Ohio, chain sees delivery as a way to battle nature itself.

"Winter can be really tough for us," Mr. Richardson said. While White Castle has a big national presence in supermarket frozen-food aisles, the chain has a large concentration of stores in colder states. Delivery has given customers another way to order when things turn cold and slushy.

It's not just the elements, though. Younger customers, including the coveted college students and professionals of Gen Z, "expect no barriers to get what they want when they want."

Perfecting the delivery process will require innovation at the restaurant and among couriers, experts and executives say. Several of the delivery companies are working on autonomous vehicle delivery in hopes of someday reducing human errors. Mr. Richardson even suggested Grubhub or a rival may invent a deep fryer for the car.

For now, we live with the dilemma of the indigestible blob, Mr. Richardson conceded. "How do you have that french fry arrive 27 minutes later to taste the same way?"

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