Photo by Siddharth Pathak
Kearney, Singapore

Food for thought: evolution of food services post-COVID-19 in Asia

KEARNEY

Post-pandemic outlook for the food service industry in Asia

COVID-19 has been the worst crisis to hit the food service industry in the post-World War II era. In 2020, the Asian organized food service market shrank 25 to 30 percent to about $925 billion. Some countries, including India, Indonesia, and the Philippines, were even more severely impacted with a 35 to 40 percent decline, either because of strict government regulations or consumers continuing to eat at home even as lockdowns lifted. As sales plunged, widespread job losses and permanent store closures of more than 20 percent occurred across markets.

While the overall industry was suffering, certain segments grew at an unprecedented rate. Online food delivery grew 30 percent in 2020, compared with less than 20 percent growth the year before. Food aggregators experienced more than 30 percent growth, accounting for 65 percent of all online food delivery orders. Cloud kitchens gained further popularity, with most established quick service restaurants adapting to the newer format to fuel growth.

To understand how consumers' preferences have changed throughout the pandemic, Kearney conducted an online survey of more than 900 representative consumers. Amid these evolving market dynamics, some players have carved their own path and defied the market decline by taking proactive initiatives—and their choices have created a differentiated value proposition:

— **Winners** have thrived by rapidly adapting to the new landscape with innovative business models.

— **Challengers** have adapted by using aggregators, but they are still hanging on to legacy business practices.

— **Laggards** have lacked the flexibility, urgency, or capability to take disruptive actions to respond to the market changes.

Less in-store dining will push food service companies toward smaller stores, accentuated by cloud kitchens and more online-to-offline takeout

— Established chains will move to a hybrid model with a combination of physical stores, takeout stores, and cloud kitchens. Smaller brands and standalone stores will pivot toward cloud kitchens.

— The average store will be smaller by about 15 percent with a reduction primarily in seating areas.

— Smaller flagship stores will continue to be relevant to build the brand.

Aggregators will start to dominate the food service ecosystem as they expand their value proposition and build their own cloud kitchen network

— There will be a continued focus on improving the consumer experience while shifting the emphasis from gaining market share to gaining mind share by increasing consumer connections and engagement.

— The portfolio of services will expand to include food service companies, such as raw materials, equipment, point-of-sale systems, and digital payments.

— Aggregators' own multi-brand cloud kitchen network will expand.

A digitalized customer journey and back-end digitalization will drive customer-centricity and operational excellence

— Customer-facing digitalization will become an industry norm. Established chains will build and strengthen their own customer-facing apps, while smaller brands will continue to depend on aggregators.

— Companies with enough scale and limited menu customization will have a head start on going digital. This will occur first in markets with a high labor cost and then in lower-cost markets.

Brand perception will be led by trust built through proactive communication and transparency around safe and healthy food sourcing and handling

- Food sourcing categories, such as organic, carcinogen-free, and non-GMO, will become more important for consumers post-COVID.
- Food handling will be non-negotiable, including COVID protocols, temperature-controlled storage, and cross-contamination prevention.
- Companies will prioritize items by consumption volume and risk level. For example, meats, fish, and dairy products will be considered high risk.

Food service companies will have to tackle a fundamental business reset and strategically reinvest to thrive in the new world

- A reboot will be required to re-evaluate operating models, organizational structures, and financials.
- Reinvestments will need to be self-funded and prioritized across a hybrid operating model, digitalization, and trust-led brand initiatives.

The food service industry will become more consolidated, and aggregators will take a larger share of the business

- About 15 to 20 percent of orders will be led by aggregators. Large chains will expand and gain share, while small players may struggle and get absorbed in the new ecosystem.
- There will be a 10 to 20 percent net decline in employee headcount. New skills will revolve around digital, data, and a new delivery model.

Less in-store dining will push food service companies toward smaller stores, accentuated by cloud kitchens and more online-to-offline takeout

Delivery and takeout orders accounted for 28 percent of all food orders in 2020, compared with 20 percent in 2019. According to our survey, 44 percent of consumers still prefer to eat restaurant food at home via food delivery or takeout even as the pandemic subsides (see figure 1 on page 3). This is also a result of newly formed social habits and accelerated trends of at-home entertainment.

Implications for food services companies

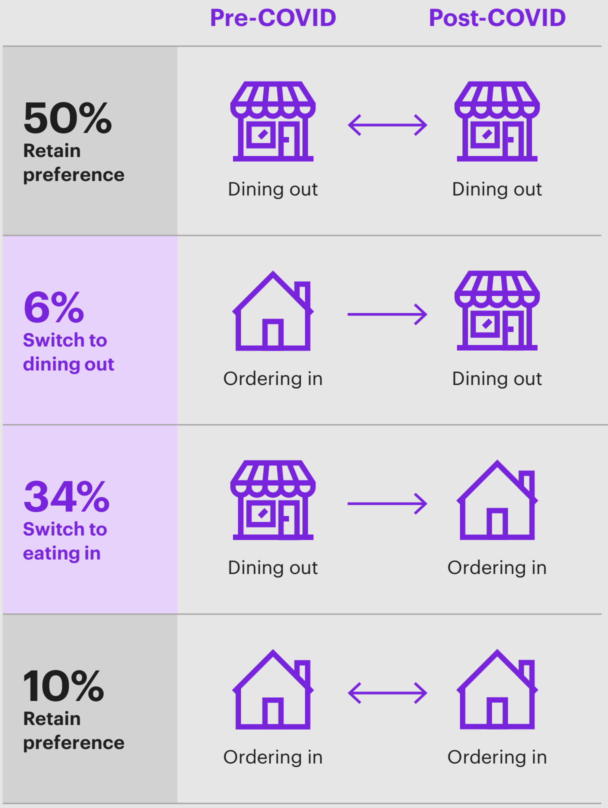
Companies will be forced to pivot toward smaller stores and revamp their network footprints. Established chains will shift to a hybrid network model, combining physical stores, takeout stores, and cloud kitchens, while many small brands are likely to close their physical stores and embrace a predominantly cloud kitchen network model (see figure 2 on page 3). In fact, this shift is already under way: an Indonesian fast-food chain with more than 150 stores opened six new cloud kitchens in the fourth quarter of 2020, and a Thailand-based restaurant group is planning to open 100 cloud kitchens over the next few years to strengthen its food delivery business.

Additionally, industry players are reducing the size of their physical stores in response to the dine-in decline. For example, several fast-casual chains in India have reduced the dining space in their stores, resulting in a 15 percent decrease in the average size of regular and flagship stores.

The store network footprint revamp will result in a 15 percent decline in average store sizes and a transition of about 30 percent of store portfolios to cloud kitchens.

Figure 1

Consumers' preferences for where they dine have changed since the pandemic began



"I have discovered so many things I enjoy about staying at home. **Even after lockdown restrictions were lifted, my family and I have eaten at home every day** for the past several months."

— Housewife, Indonesia

"While we have started to see an uptick in the lunch crowd, we see larger ticket orders for takeaway."

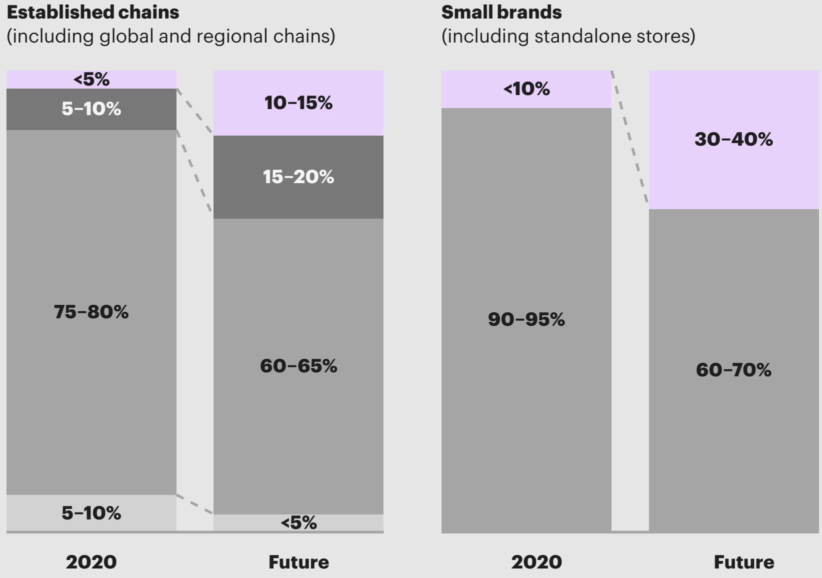
— Noodle seller, Malaysia

Source: Kearney analysis

Figure 2

The landscape is changing for food service companies

Expected store network evolution for food service companies (% of stores by type within network)



Cloud kitchens will become more prevalent for both types of brands, decreasing the size of the average network store.

Takeout stores will increase for established chains as a middle ground between cloud kitchens and physical stores.

Physical stores will decrease in number and size for established brands but may be eliminated by many small brands.

Flagship stores may decrease but will remain relevant for established brands to attract new customers and provide an experience.

- Cloud kitchens (about 40 square meters)
- Takeout stores (about 70 square meters)
- Physical stores (about 150 square meters)
- Flagship stores (about 300 square meters)

Source: Kearney analysis

Aggregators will start to dominate the food service ecosystem as they expand their value proposition and build their own cloud kitchen network

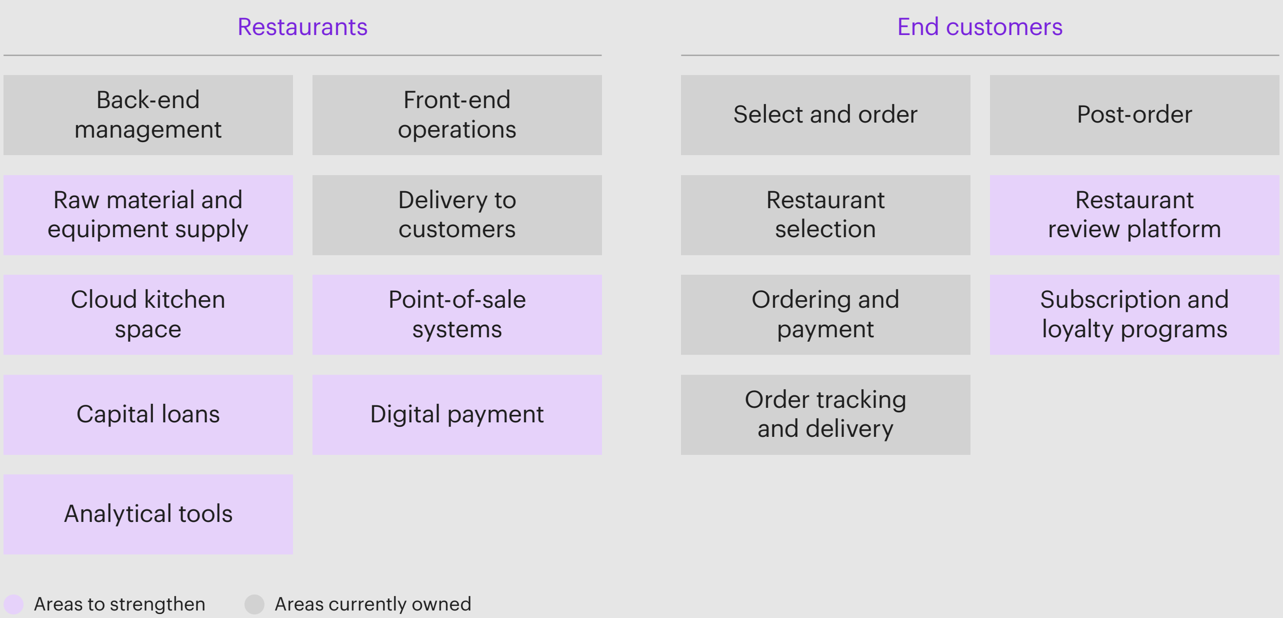
In less than 10 years, aggregators have substantially disrupted the food service industry—erasing the physical distance between consumers and restaurants. Consequently, proximity has become less of an advantage, while other aspects such as ambiance, service, and taste have become more important in determining a restaurant’s value proposition.

Implications for food services companies

Aggregators have been able to grow rapidly and establish consumer loyalty by providing unparalleled convenience and a variety of offerings (see figure 3). Within the consumer space, aggregators are shifting their focus to connection and engagement to capture a larger mind share.

Meanwhile, in the B2B space, aggregators will become a one-stop shop for food service companies, significantly expanding their value proposition by integrating services. These additional services will improve operational efficiency and provide opportunities for growth, especially for smaller brands.
The levels of automation and digitalization that are typically available only to large established chains will become available to all players thanks to aggregators. For example, a leading aggregator in India has started offering a table management service to help restaurants optimize occupancy, reservations, customer relationship management, and staff schedules, and another aggregator has set up more than 50 cloud kitchens across Thailand, Singapore, Philippines, and Indonesia.

Figure 3
Aggregators’ value proposition is expanding



Source: Kearney analysis

A digitalized customer journey and back-end digitalization will drive customer-centricity and operational excellence

Even before the pandemic, the food service industry pivoting to digitalization. For example, a Chinese hotpot chain opened a “smart restaurant” using artificial intelligence (AI) and machine learning (ML) to automate its kitchen operations, a leading fast-food chain in China created a platform for personalized online ordering along with community and loyalty programs, and a pizza chain in India adapted its app in multiple local languages to increase adoption and consumer connection.

These trends will only accelerate, driven by the higher demand for convenience, fierce competition for operational efficiency, and exponential technology advancement. The industry’s digitalization will unfold in two areas (see figure 4):

— **Customer-facing digitalization.** Digital ordering, payment, loyalty programs, localized and personalized content (such as location-based alerts and offers), and integration with other services (such as Spotify and YouTube)

— **Operations digitalization and mechanization.** Ensuring quality through AI/ML-based analytics, robotics in delivery, Internet of Things sensors for inventory management, and auto-replenishment via forecasting algorithms

Implications for food services companies

Customer-facing digitalization

— As the highly demanding next-generation consumers begin to dominate the market, a digital customer journey will become an industry norm. Established chains and small brands will both move fast.

— Established chains will build their own internal front-end network, localizing the app to each market, while smaller brands will embrace aggregators and ready-made market solutions.

Figure 4
Technology will change the face of the customer journey in the food service industry

Customer-facing digitalization

Illustrative

1. QSR selection
— Drive visibility for health and safety measures as well as food sources.
— Use data-driven auto-replenishment of ingredients.
QR code

2. Browse menu
— Offer an online menu with fast-moving dishes and semi-prepared, DIY meals.
Digital platform

3. Order
— Partner with food-ordering mobile applications.
Digital platform

4. Payment
— Partner with mobile payment applications and contactless card services.
Digital platform

5. Preparation
— Automate processing, and reduce human touch.
Automation and robot chef

6. Service
— Automate processing, and reduce human touch.
Drone and robotic delivery

7. Dining
— Develop crowd management services and processes.
Digital platform

8. Loyalty
— Boost the use of loyalty programs.
Digital platform

Customer-facing digitalization   Operations mechanization

Note: QSR is quick service restaurant.
Source: Kearney analysis

Operations digitalization

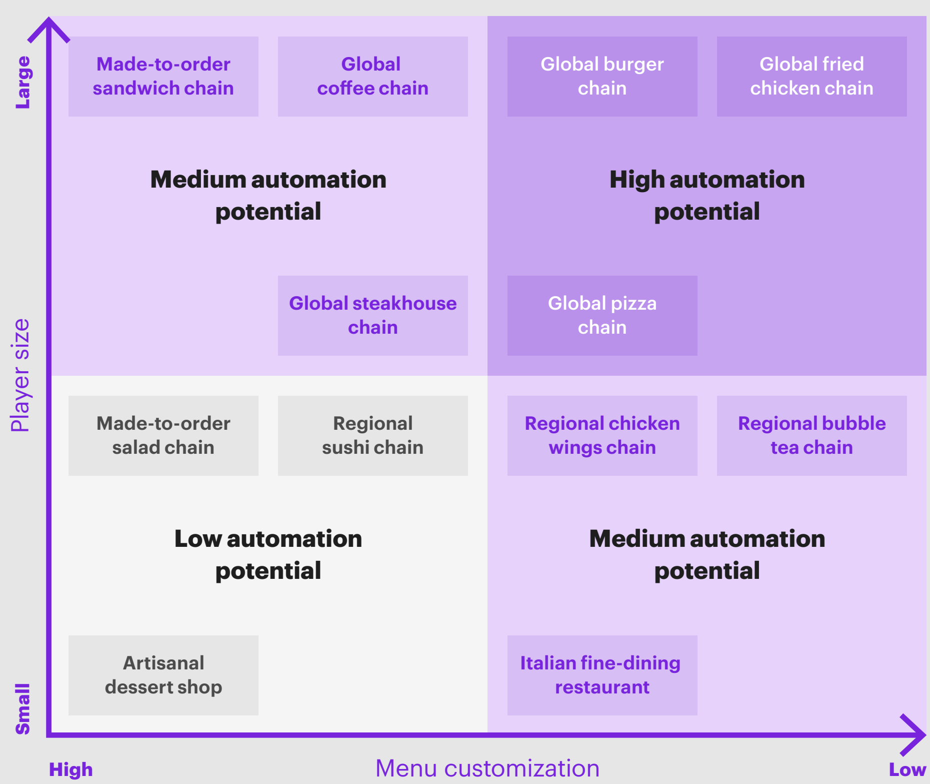
- Two factors will impact the adoption of operations digitalization: player size and the level of menu customization (see figure 5). Large global chains with standardized menus have the biggest potential to digitalize their operations. Additionally, this shift will be phased across markets, with the ones with higher labor costs such as Japan and Singapore moving first since they stand to gain more by digitalizing their operations.

- Large global chains will partner with best-in-class technology players to automate operations and bring in the latest AI/ML technology for inventory management, quality assurance, and digitalizing core operations (order-taking, food processing, cooking, and delivery).

Brand perception will be led by trust built through proactive communication and transparency around safe and healthy food sourcing and handling

Between 2015 and 2018, a leading US Tex–Mex food chain was severely impacted by dozens of food poisoning outbreaks—leading to millions of dollars in punitive damages and significant loss of consumer trust. This scandal reminded us that food safety is a top priority in the industry. Our survey affirms this point of view, indicating that health and safety is the top consideration in consumers' food choices (see figure 6 on page 7). Transparency about food sources—knowing where the food comes from and how it is prepared—is also becoming a priority. According to our survey, 61 percent of consumers are willing to pay more to know where their food comes from (see figure 7 on page 7). It is also becoming more important to have organic and vegetarian options.

Figure 5
Large food service chains with standardized menus have the biggest potential to go digital



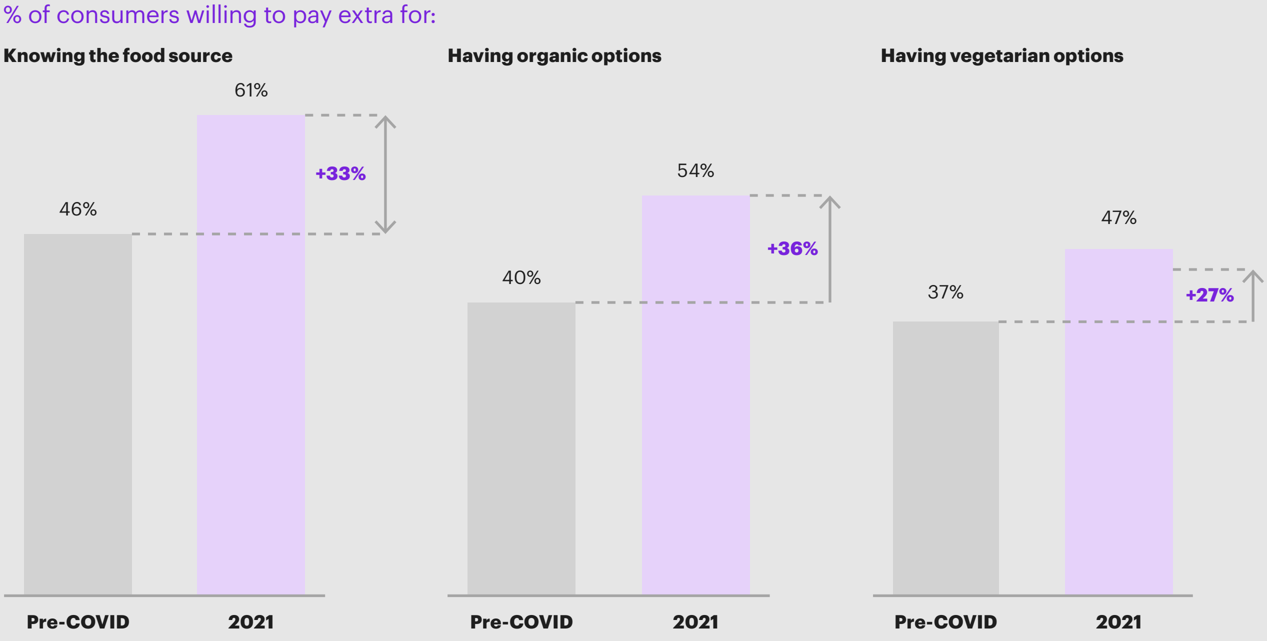
Note: Player size is based on the total number of stores.
Source: Kearney analysis

Figure 6
Consumers are most concerned about health and safety when it comes to their food

Factors of considerations	COVID impact	Rank: Pre-COVID	Rank: Post-COVID
Health and safety	↑	3	1
Taste	↓	1	2
Price	↓	2	3
Menu variety	–	4	4
Convenience	–	5	5

Source: Kearney analysis

Figure 7
Most consumers are now willing to pay more to know where their food comes from



Source: Kearney analysis

Implications for food services companies

Moving forward, trust will no longer be an afterthought for food service companies but the top item on their agendas—driving the brand value proposition and pulling in larger investments. Companies will have to prioritize trust-building with proactive communication and transparency as a prerequisite for success; food stories will become a significant medium through which they can earn consumers' trust.

Trust-building can manifest in different ways depending on the size and type of food service company, but most will focus on two functions to build trust with their customers: food sourcing and food handling. For example, a global coffee chain incorporates its "food story" across the walls of its stores with maps highlighting the origin of its coffee beans and farmers' stories. Another example is from a burger chain with more than 180 locations across Japan. The restaurant continues to grow thanks to its commitment to providing hand-made meals from locally sourced fresh ingredients. The chain gives detailed information about the ingredient sourcing and processing as well as the nutritional value of each item on the menu.

Trust will no longer be an afterthought for food service companies but the top item on their agendas.

Food service companies will have to tackle a fundamental business reset and strategically re-invest to thrive in the new world

As the economic impact of COVID-19 and consumer preferences continue to evolve, companies will need to perform a fundamental business reset to prioritize initiatives and chart the best way forward and then make significant strategic investments to adapt and succeed.

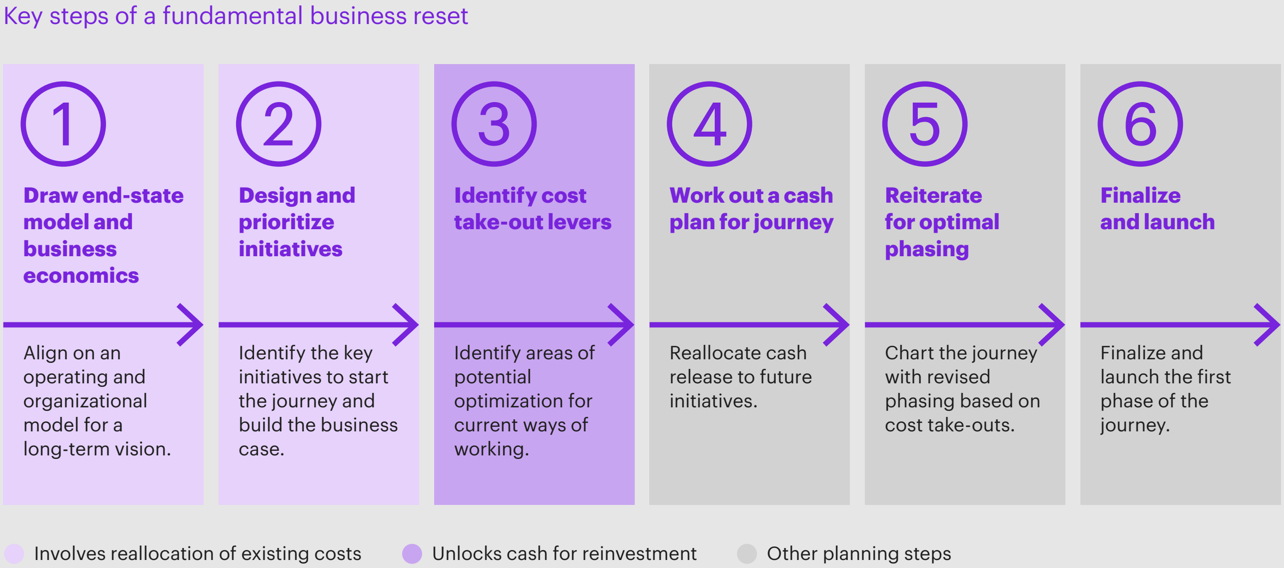
Global players in North America are already on this journey, and players in Asia will soon follow. For example, a US coffee chain is transforming its asset base by closing 400 of its underperforming locations by the end of this year. The chain plans to reinvest and open 300 stores with innovative formats, focusing on mobile-only, curbside pick-ups, and drive-through.

Implications for food services companies

A fundamental business reset will require an end-to-end re-evaluation of the operating model, organizational structure, and costs over a six-step journey (see figure 8 on page 9). Reallocating the existing costs through the fundamental business reset will repurpose about 30 percent of the current cost baseline into other initiatives, such as a new operating model, new store formats, and cloud kitchens (see figure 9 on page 9). A comprehensive cost optimization can capture cost savings of more than 10 percent, driven predominantly by improvements in personnel, rental, and direct material sourcing. These savings can then be reinvested into the company to fund future waves of initiatives that address other themes, such as digitalization or the new value proposition.

Figure 8

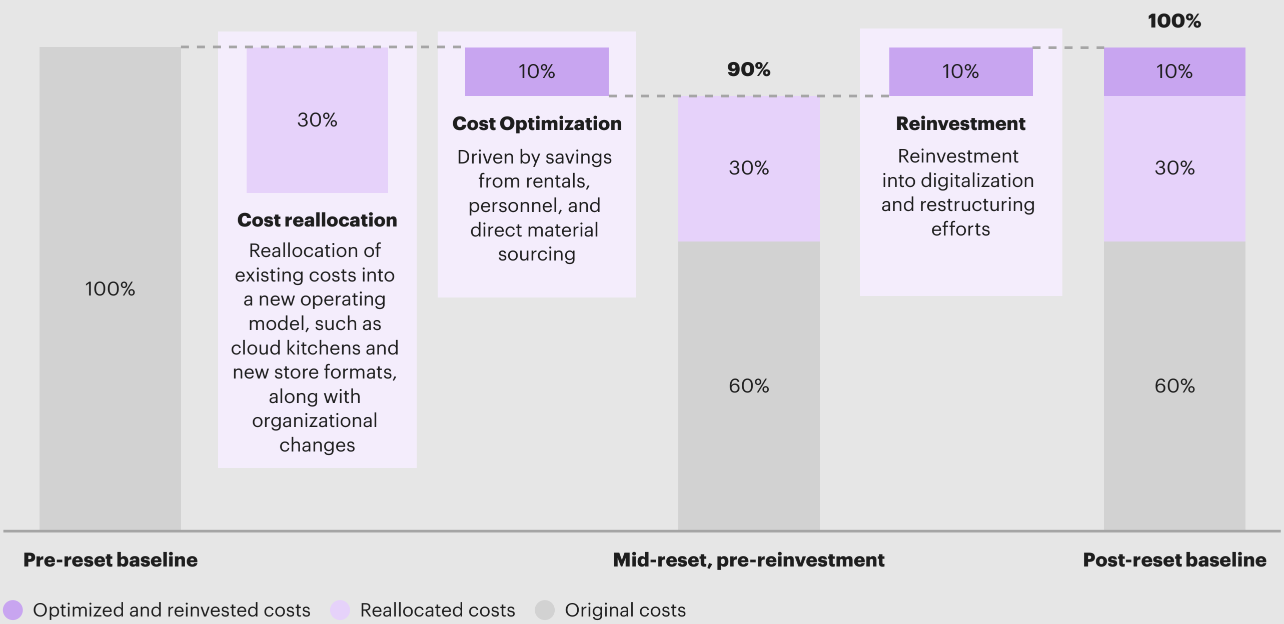
Forward-thinking food service companies are re-evaluating the way they do business



Source: Kearney analysis

Figure 9

The cost structure for food service companies is evolving



Source: Kearney analysis

The food service industry will become more consolidated, and aggregators will take a larger share of the business

Looking back, 2020 and 2021 will be the years when the food service industry truly experienced "survival of the fittest." This period has brought an accelerated democratization of food, where customers have a growing pool of culinary options and where food service companies are forced to rely solely on their value proposition to compete.

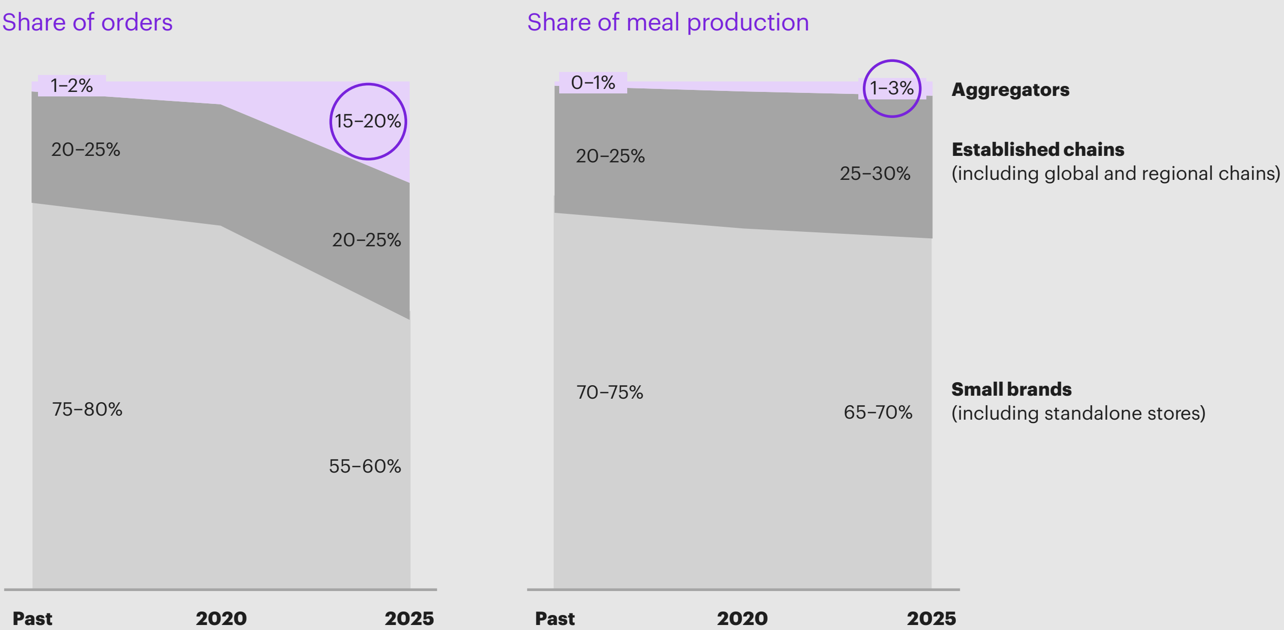
Correspondingly, the industry's structure will shift as store closures and market consolidation accelerate amid changes in consumer behaviors and the growing dominance of aggregators. At a portfolio level, food service companies will consolidate to achieve higher economies of scale, larger companies will acquire smaller companies that have high growth potential, and aggregators will acquire companies to enhance their value-added services (see figure 10).

Aggregators will continue to grow rapidly and become more influential in the ecosystem as they embark on new partnerships, expand their value proposition, and create their own cloud kitchen network.

Established chains that adapt and innovate will continue to generate stable revenues but will have to revamp their store network models and build their own platform or partner with aggregators to stay ahead of the curve.

Many **small brands and standalone stores** that have played a large role in the Asian food service industry in the past will have two avenues: they will either be consolidated with the larger chains or have to partner with aggregators and create a new proposition for themselves in the hybrid world of eating out and delivery.

Figure 10
The structure of Asia's food service industry is changing



Source: Kearney analysis

Other regulatory and macroeconomic implications

As the industry continue to evolve, the nature of employment will also shift. The rise of delivery and cloud kitchens will shift overall headcount from physical stores (a 20 to 30 percent decline) to cloud kitchens and delivery infrastructure (a 10 to 20 percent investment), resulting in a net overall headcount decline of 10 to 20 percent.

Additionally, digital penetration and transformation will create the need for new skills around data and the delivery model. Development in adjacent industries, such as the supply chain, farming, and packaging, will also impact the skills that will be required.

Aggregators will thrive, established chains will expand their footprints, and smaller brands will have to transform and lean on aggregators to survive.

Authors

Siddharth Pathak
Partner, Singapore
siddharth.pathak@kearney.com

Shirley Santoso
Partner, Jakarta
shirley.santoso@kearney.com

Rajat Tuli
Principal, Gurugram
rajat.tuli@kearney.com

Nitin Gandhi
Principal, Singapore
nitin.gandhi@kearney.com

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