

Food - Delivery Start-Ups : In Search of the Core

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Abstract

In the era of growth of Internet-based start-ups, the food technology business is fast emerging as a service to watch out for. Double-digit growth and spectacular predictions for the future despite cut throat competition have led to considerable excitement in this space. Food technology start-ups attracted considerable investor interest in 2015. However, in the first quarter of 2016, funding slowed down, taking a toll on cash starved food startups. Last year witnessed either closure or scaling down of operations of few pioneering start-ups in the food delivery business in various cities in India. This has compelled the food tech startups to revisit strategies and take a relook at their business models. Rather than burning cash in the name of customer acquisition, its time these companies start creating value for restaurants and customers alike. On this premise, the secondary research was undertaken for the period up to March 2016 to examine the key success factors and viability of the food-delivery business.

Keywords : food tech start ups, food delivery, on demand food industry, on-demand marketplace, online food-ordering

JEL Classification: M30, M31, M37

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The startup ecosystem in India looks truly promising. India is the fastest growing startup-base worldwide and stands third in technology-driven product startups just after the U.S. and UK, respectively ("NASSCOM startup ecosystem report 2015 : India the next tech hotbed," 2015). Low entry barriers in the tech/digital space coupled with excellent talent, rapidly evolving technology, booming domestic market, and foreign funding have enabled the Indian startup space to take off like never before. Last year, the government kicked off the 'Startup India Initiative' followed by unveiling of the action plan for the same in January this year, giving further thrust to the cause of employment generation and wealth creation. Some Indian startups in the digital space have gone beyond the \$1 billion valuation mark.

However, the roadmap to profitable growth is elusive. Achieving desired scale at the pace required calls for funding, which has slowed down since the beginning of 2016. Indian tech startup models are predominantly disruptive by nature. They have enabled online transformation of traditionally offline businesses. After electronics and fashion, the next retail segment to go online is the food business. The on demand food industry has disrupted traditional markets by adopting a *full cycle approach* to the three basic components of a meal experience at a restaurant: ordering, cooking, and delivering ("Food on demand: Business models of meal delivery startups," 2015). The sector appears to be promising due to its massive size and high repeat ordering behavior leading to

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brand creation and strong lifetime value of a customer, high margins leading to fundamentally strong business, and lack of large national brands in the space and thus room to disrupt by creating such food brands and infrastructure.

The organized food business in India is worth \$48 billion of which food delivery is valued at \$15 billion. With online food delivery players like Foodpanda, TastyKhana, TinyOwl, and Zomato building scale through partnerships, the organized food business is headed for some exciting yet turbulent times (Bhupta, 2015). The restaurants are viewing this space with great interest as food delivery startups provide an additional channel and have the potential to reduce their customer acquisition costs, which is said to be as high as 30- 40% of the revenue. The customers, on the other hand, are fast adopting this channel, which offers variety and convenience.

Various Types of Food Start-Ups

Food tech startups can be divided into four categories based on the service they provide :

Model A: Those which only facilitate *search and discovery of restaurants*,

Model B: Those which facilitate *ordering*,

Model C: Those which facilitate *ordering + delivery*,

Model D: Those which facilitate *ordering + delivery + cooking*.

Model A signaled the beginning of food tech startups in India. Burrp was the first food tech company in India followed by Zomato; both tried to bring technology to the restaurant search and discovery space. This was followed by Model B which facilitates only ordering. These act as a pure software layer that aggregates fragmented offering of independent restaurants (mainly takeaways), which manage their own fleet of couriers (JustEat, Grubhub, Delivery Hero in U.S.). These software only market places ("Food on demand: Business models of meal delivery startups", 2015) and bring a lot of new orders for restaurants and replace their age old phone-ordering system with web and mobile platforms. They neither cook nor deliver the food ; hence, cannot exercise control over the quality of food or the delivery service. Their revenue per order is the lowest among B, C, and D models. Being purely software business, they are highly scalable and have experienced remarkable growth.

The third Model C - the order and delivery model or on-demand marketplace is the forte of companies like Zomato, Delyver, Foodpanda, and TinyOwl. This model facilitates easy ordering through an app or website interface where the menu of a restaurant is uploaded. They earn revenues by charging the restaurants commission and also charge a small fee to customers for the order. Often, the prices on the menu are marked up by restaurants to pay their commission. Currently, some of these companies are offering discounts to acquire customers. Unlike the previous model, these online food-ordering marketplaces have a significant amount of operational work to do since they also manage logistics and ,therefore, are not easy to scale up. However, once they acquire scale, they benefit not only from strong entry barriers in a city, but also from higher commissions they charge to restaurants. Their major advantage is that they can offer a wide choice of restaurants and price points that software-only marketplaces cannot.

Model D includes online only food kitchens/cloud kitchens and meal kits or ready to cook meals, more popular in U.S. and Europe, but fast catching up in India as well. CalorieSmart and Yumist in Gurgaon, and HolaChef in Mumbai; Munchery , Blue Apron, Spoonrocket, Sprigin in U.S. are examples of this model. As they opted for a full integration of the process, they developed their own app through which consumers can order limited range of meals prepared in their kitchens, reheated in their own fleet of cars as orders come in, and delivered in 15 minutes (as they save on the kitchen preparation time). They trade choice for convenience and a highly curated experience (Mignot, 2015).

Sustainability of the business enhances as one moves from Model A to Model C, providing additional service

and charging a fair share for the value addition. Model C- the on demand marketplace - offers best overall value for money for customers due to variety of cuisines and price points and reliable delivery experience at no additional cost to customers. Questions are still being asked and answered across the board on the pros and cons of various business models adopted by food tech organizations. Amongst the existing variety of business models trying to offer differentiated services by juggling between mode of ordering food, variety of food offered, and other service quality parameters, it is only natural that only a few will survive.

Funding from Global Investors

In India, in the past 1 year, there has been exponential growth in the number of food startups. They have also been able to attract significant funding from global investors. The Table 1 mentions the number of deals and total funding received by Indian food-tech start-ups.

Table 1. Year Wise Funding Received by Indian Food Tech Startups

Year	No of deals	\$ mn
2013	9	30.48
2014	13	70.71
2015	54	236.55
2016 (Till Feb 2016)	3	51.46
2016 (extrapolated)	..	250 mn
Total (till Feb 2016)	79	397.31 mn

Source: VCC Edge

As can be seen from the Table 1, during the initial period, the number of deals in VC funding went up from 13 in 2014 to 54 deals in year 2015, and investments rose from \$70.71 mn to \$236.55 mn in 2015. However, recently, during the first two months of 2016, the number of deals fell to only 7 compared to 25 during the same period in 2015 and the total value reduced from \$77 mn to \$ 291mn.

Major Players in the Restaurant Food Delivery Space in India

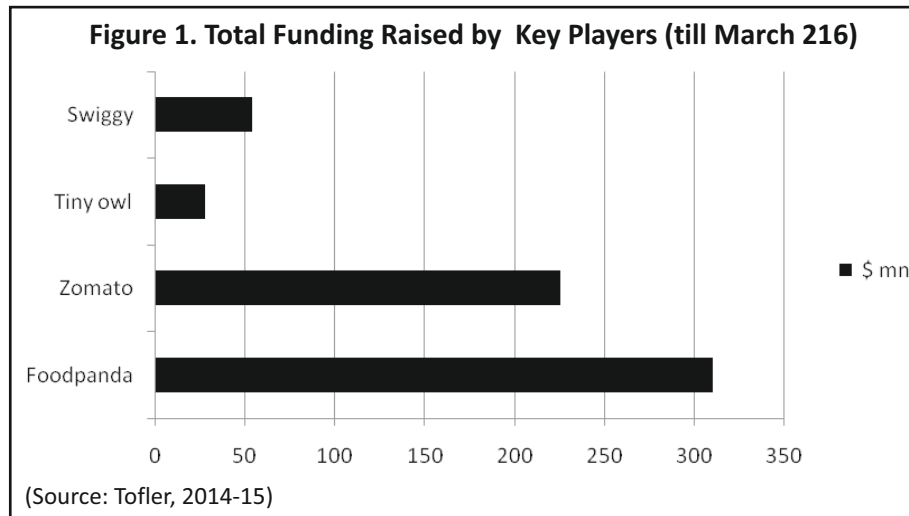
Leading restaurant food delivery start-ups in India are Foodpanda, Zomato, Swiggy, and TinyOwl. They connect customers with restaurants through their app or website, receive orders online, pass the same to restaurants, and execute delivery. They add value by giving customers choice of restaurants, cuisine, and price points. Funding received by various food delivery start-ups is shown in the Figure 1.

Foodpanda is a Berlin headquartered global online food delivery marketplace which commenced its operations in Singapore in 2012. Its Indian business was launched in the same year. At present, Foodpanda is functioning in 100 plus cities. It acquired food tech start-ups TastyKhana and Justeat in 2015. In India, Foodpanda has received \$310 mn funding since inception (Refer to Table 2).

Zomato was founded in 2008 and is the oldest and one of the successful Indian start-ups. Started primarily as a restaurant search and discovery website & app, currently, it has a database of 1.2 million restaurants in 23 countries across the globe including U.S. and has received a total funding of \$225mn (Refer to Table 2). Since the month of April in 2015, it also ventured into restaurant food delivery space in India (Fok & Advani, 2015). However, according to published data, 80% of its revenue is still generated from advertising on its site (Tofler, 2014-15).

Table 2. Statistics of Food Delivery Startups in India

Start-up	Year of inception	No of cities	No of restaurants	Funding raised
Foodpanda	2012	Around 100 cities	4,000	\$310 mn
Zomato	April 2015	14 cities	12000	\$225mn
Tiny owl	2014	Mumbai, Delhi, Hyderabad Bengaluru	650	\$27.67mn
Swiggy	2014	Bengaluru, Hyderabad, Mumbai, Delhi, Chennai, Kolkata, Pune, Gurgaon	5000	\$53.5mn



Swiggy is a Bangalore based food delivery app founded in August 2014 and is one of the newest entrants in this segment. With a fleet of 3500 employees, it has now expanded its business in eight cities. Swiggy, which has received sizable funding to the tune of \$53.5 mn since its inception, has made a mark in this space in India (Refer to Table 2). At present, Swiggy looks the most promising start-up in this space. The company has recorded 20 times growth in volume from 1000 orders per day in April 2015 to 20,000 orders a day at present.

TinyOwl is a Mumbai-based food ordering startup, which too started operations in August 2014. TinyOwl has raised \$27.67 mn in four rounds of funding so far (Refer to Table 2). After the rapid expansion in the initial stages, it seems TinyOwl is facing trouble in raising cash from investors. In 2015, TinyOwl started operations in Pune region but had to close down within a few months (Pahwa, 2016). According to recently published reports, TinyOwl is planning a merger with a delivery service start-up Roadrunner to create an integrated hyper-local delivery service. This move will improve their unit economies which will enable them to raise funds going forward.

Objectives of the Study

The key objectives of this paper are :

- (1) To identify the existing challenges and opportunities for growth for the food delivery start-ups,
- (2) To throw light on the trends in the food-delivery start-up segment,
- (3) To analyze the viability of the food-delivery segment in India,
- (4) To understand how innovative strategies can be adopted by players to create differentiated offerings.

Research Methodology

The research is based on secondary data. Information on restaurant aggregators and delivery start-ups was collated from industry reports, newspaper articles, and research studies in the relevant field to synthesize current thinking and outcome in future. Strategies have been conceptualized and conclusions have been drawn based on the study. This study is conducted based on data available for the period up to March 2016.

Demand Drivers of Online Food Delivery Business

(i) Emerging Economy : In contrast to other major developing countries, growth in India remained robust in 2015. India has also relatively outperformed other BRIC economies. The World Bank projected that India will grow by a robust 7.8% in 2016 and 7.9% for the next two years ("India will remain the fastest growing economy in 2016: World Bank," 2016), which is a good sign for the growth of ecommerce and online food businesses in India.

(ii) Growing Middle Class in India Fuelling Consumption : India is a consumption driven economy. In fact, as per McKinsey Global Institute (MGI), spending in India is expected to increase about 2.5 times by 2025. The middle class population in India is going to increase by about 12 times during 2005-2025, fuelling consumption demand. The growing middle class and increasing disposable income provides many investment opportunities in the consumption domain. E-commerce companies will be significant beneficiaries of the increased consumption demand in India over the next two decades ("Growing middle class in India to fuel consumption demand," 2016).

(iii) Internet Penetration : The past few years has shown tremendous growth in the Internet user base, with an exponential increase in Internet usage. A significantly low (19%) but fast-growing Internet population of 243 million in 2014 is an indicator of the sector's huge growth potential in India. In absolute terms, India's Internet users are short by only 36 million as compared with 279 million in the U.S. and higher than that in Japan, Brazil, and Russia. However, in relation with its population, only 19% Indians use the Internet. This indicates the potential of Internet use in India. As Internet penetration increases, the potential of growth for the e-commerce industry will also increase (PWC, 2015).

(iv) Demographics : India has a young population compared to most nations. It has approximately 65% of its population below the age of 35 years. An analysis of the demographic profile of Internet users further testifies that e-commerce will rise rapidly in India in coming years. Around 75% of Indian Internet users are in the age group of 15 to 34 years. This category shops more online than the remaining population. Peer pressure, rising aspirations with career growth, fashion, and trends encourage this segment to shop more than any other category. India, therefore, clearly enjoys a demographic dividend that favours the growth of e-commerce (PWC, 2015).

(v) Growing Discretionary Spending : Growing income and rising disposable income over the next two decades will result in the discretionary spending to increase from about 52% in 2005 to about 70% of the customer wallet by 2025, according to MGI. The growing discretionary spending will result in demand for appliances, communication, and healthcare ("Growing middle class in India to fuel consumption demand," 2016). This growth in discretionary spending will also fuel the growth of e-commerce in India. Food delivery startups will benefit from it as well.

Challenges Faced by Online Food Delivery Start-Ups

(i) Capital Intensive : Despite favorable demand drivers, survival and growth is not easy for food delivery start-ups. Just like other E-retail businesses, online order and food-delivery businesses too are capital intensive requiring substantial investment in delivery infrastructure and profitability is achievable by scaling up the operations (Singh, 2016). However, scale may be difficult to achieve in shorter time period as the Indian customer is still getting accustomed to ordering food online.

(ii) Customer Acquisition Costs : To scale up operations, food delivery businesses are burning cash to offer substantial discounts termed as customer acquisition costs. Customer acquisition costs are creating a big hole in the pockets of food delivery companies.

(iii) Unit Economics : Achieving unit economics is the key to sustainable growth in the food tech space. Unit economics is calculated as revenue per order minus the cost of service. In order to improve unit economics, the companies should stay away from product- discounts. However, in absence of product differentiation, offering discounts is the only way to achieve scale. Making a choice between profitability and scale is a catch-22 situation indicating a flawed business model.

At present, the business has negative returns as they offer heavy discounts per order and if at all, charge only a small amount of ₹ 30 to ₹ 45 as delivery charges. Also, lower average ticket size is harming unit economics (Krishnan, 2016).

(iv) Limited Delivery Time : Food-tech businesses have an additional constraint of restricted delivery time, limited to 30 and 40 minutes as food delivered beyond 1 hour of preparation becomes cold and loses taste. This is coupled with additional challenge of unknown location of demand origination and other external circumstances like traffic on roads leading to delay in delivery. The companies are trying to solve this problem by becoming hyper local (Somani, 2015).

(v) Too Many Players : Due to the Internet boom and the sheer size of the food market, many local cloud kitchens and delivery start-ups have emerged in this space. Multiple smaller start-ups have set-up their websites and are offering food delivery only in particular region or in city, thereby intensifying competition in the space. In India, out of the total 145 food-tech start-ups existing by end of 2015, 66 start-ups had started their business in 2014 (VCC Edge, 2016). The emergence of a number of players within a short span of time has aggravated competition in the food delivery business and food aggregators are feeling the heat of it (Singh, 2015).

(vi) Channel Power and Network Effect : In the hospitality industry, online intermediaries like MakeMyTrip, Airbnb, etc are exerting considerable channel power. Convenience, time saving, and cheaper prices are the most common motivations for customers to book hotel or travel service online which the online travel agents/intermediaries have fulfilled. Additionally, with an increasing number of customers adopting the online channel, a network effect has been created. While the core proposition of food delivery companies remains convenience for customers, food delivery startups need to go beyond and deliver quality food, which unfortunately they can't influence. Hence, reaching critical mass will be a challenge for these organizations in India. Without a sufficient number of products to offer economies of scope, distribution costs will be extraordinarily high and will reduce or eliminate consumer adoption of this new channel unless the channel operator is willing to sustain large losses by subsidizing logistics ("Changing channel distribution models in the Internet age," n.d.). This is what is happening in the food delivery space in India today. Hence, these intermediaries have not acquired channel power and do not have a network effect.

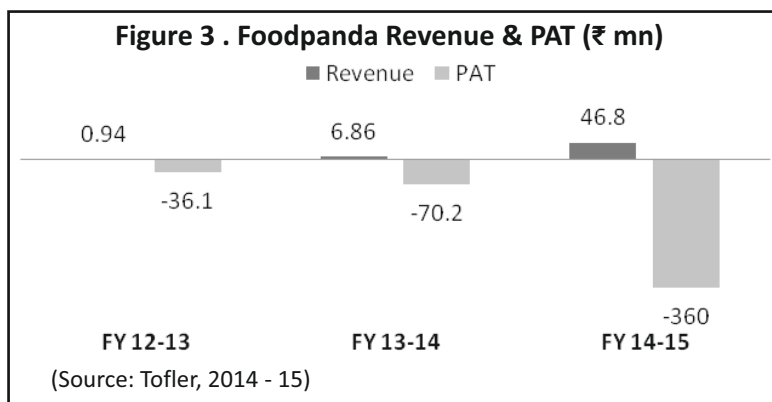
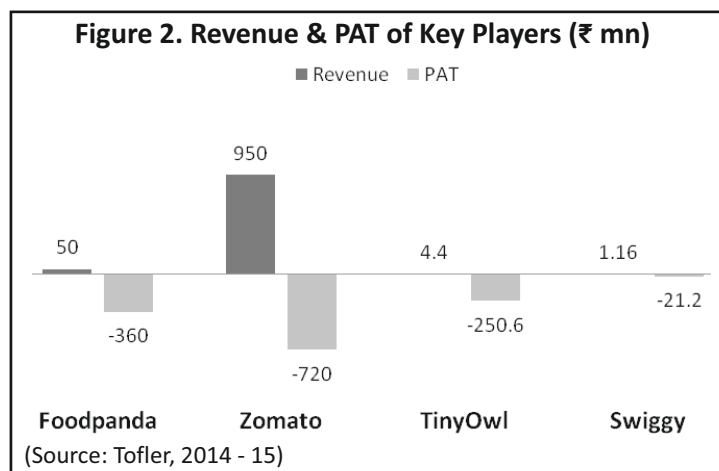
(vii) The Indian Consumer : Since the pre start-up era, Indian customers are adapted to ordering food from their favorite restaurant on phone and are aware of menu and prices of their desired food. Also, their favorite restaurant too has been delivering food to their customers. Food-tech start-ups are actually a disruption in the traditional food-delivery business. Food - tech start-ups aim to provide delivery infrastructure to restaurants in return of 10% to 15% commission on order-value. This may be an additional delivery channel for suppliers, but overcoming barriers formed by the customers' habit is an additional challenge for food-tech businesses.

Cost - Structure & Profitability

Revenue and PAT figures of leading restaurant food delivery start-ups such as Zomato, Foodpanda, Swiggy, TinyOwl indicate that at present, barring Zomato, all others are incurring huge losses (Refer Figure 2). As Zomato is primarily in restaurant aggregation and information business, 80% of its revenue comes from advertising on its site (Tofler, 2014-15). Both Swiggy and TinyOwl started operations in 2015.

An analysis of past 3 years' financials of Foodpanda indicates that revenue of Foodpanda shot up more than seven times in 2013-14 and 2014-15 as well (Refer Figure 3). This coupled with favorable demand drivers suggests that the food tech business is on an upward trajectory.

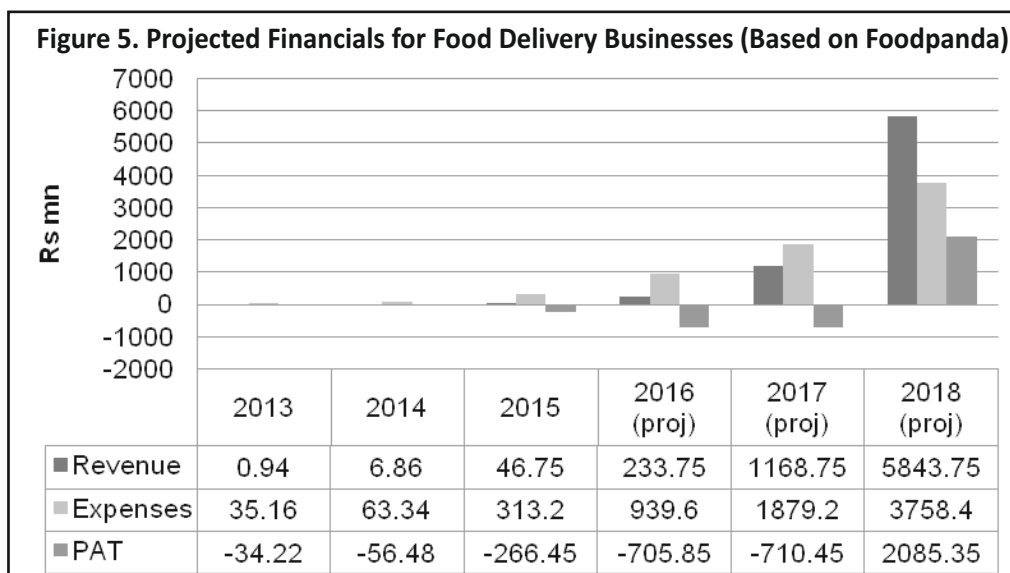
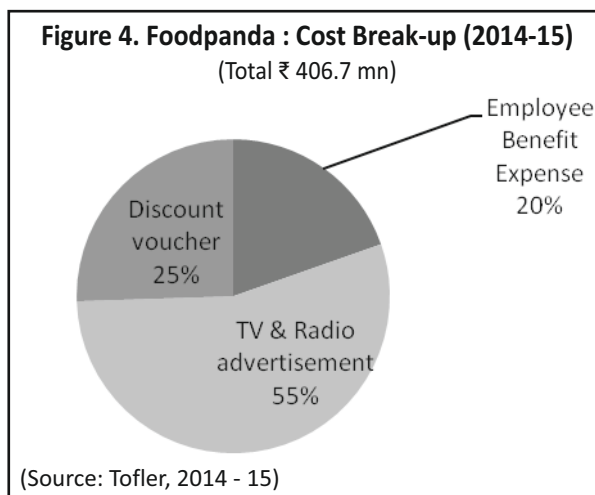
Cost break-up of Foodpanda indicates that a major chunk of expenses are incurred on discount vouchers and combined expenses on advertising (80%) (Refer Figure 4). Almost 55% of the total expenses of Foodpanda are attributed to advertising, aimed at yielding favorable results in the medium term. These expenses can create



additional revenue streams in the form of listing fees from restaurants, banner advertisements, and higher commission per order. However, in September 2015, Foodpanda laid off 15% of its workforce, raising a red-flag.

Looking at the present numbers of revenue and losses of various food-delivery start-ups, the feasibility of the business is a matter of debate. In order to forecast future trends in revenue and profits, their financial projections are made. Foodpanda being the only company in this space with past three years' available data (Refer Figure 5), it has been considered for our study.

Analysis of past data indicates growth in revenue by 600% to 700% p.a in 2013-14 and 2014-15, while its expenses had gone up by two times in 2013-14 and by five times in 2014-15 (Tofler, 2014 - 2015). For a sunrise industry in the high growth phase, we extrapolate revenue growth at 500% (5 times) p.a. for the next 3 years and anticipate expenses to rise three times and two times, respectively per annum for the coming 2 years. As can be inferred from the Figure 5, though revenue is very low at the moment, at five times magnification each year, it will rise astronomically 125 times in 3 years, and it is possible that the company will turn profitable and the cash flow will be positive at the end of 3 years. Identification of key success factors is crucial in achieving the desired growth in revenue.



Global Experience

The survival of Foodpanda and other restaurant delivery start-ups will depend on how long investors fund their losses. A study of past trends in food tech start-ups in matured markets such as the U.S. and Europe can provide a suitable answer to this impasse.

In U.S., online food start-ups have existed since the last 10 years, and the biggest players in this space are Yelp, Grubhub, and Open table. In Europe too, they have been operating for the last 10 to 12 years and the leading players are JustEat and Delivery Hero. Other popular online restaurant discovery apps in U.S. are Foursquare, Eat24, Dish.fm, Zagat, etc.

GrubHub (Seamless) uses the marketplace model similar to Foodpanda. It started in 2004 and is the pioneer of the restaurant food delivery business in the U.S. Presently, it is a listed company and has around US\$2.3bn market cap with 2014 revenues approximately US\$250m. Before it went public in the year 2014, Grubhub received a total of \$24.1 million in multiple rounds of funding during 2007 and 2013. The company's financial data indicates that the company has been profitable since 2010. This means that the VC investors funded losses for the first 5 to 6 years (Crunchbase, 2016a.).

Just Eat, the UK based leader in online takeaway food business was established in 2001 and raised \$88.99 mn in multiple rounds of funding since 2009 to 2013. The company incurred losses till 2011 after which it turned profitable and went public in 2014. The company has made 11 acquisitions in different countries, which is indicative of a dominant trend of mergers and acquisitions which are obvious to happen as competition intensified and food-tech market matured. The company has received funding for a total of 5 years (Crunchbase, 2016b.).

Foodpanda, in the global market, has partnered with Subway, KFC, Pizzahut, and 60,000 restaurants across several countries. Foodpanda has raised a total of \$218 mn in six rounds of funding from 2012 to April 2015. It has made 11 acquisitions in several countries (Crunchbase, 2016c.).

Ele.me in China is a successful food delivery start-up partnering with 3,00,000 restaurants in 260 cities. It has received a total funding of \$1.1 billion. It has earned revenue of \$9.5 million in daily orders. It has 10,000 employees and is valued at \$3 bn (Crunchbase, 2016d).

Managerial Implications

(i) VC Funding : VC funding pattern in matured markets indicates that investors fund food tech start-ups for a maximum of 5 years' duration. Let us assume a conservative figure of only 4 years for the Indian market. Hence, it is imperative that food tech companies have to stay away from burning cash in the name of customer acquisition costs and focus on profitability at the early stage of business. Certain measures, such as comprehensive study of Indian market to identify most profitable cities, partnering with quality-conscious reputed restaurants with proven track records, setting stringent service quality standards and conducting frequent appraisal of expenses, if undertaken by the food tech business, will go a long way in enhancing profitability. In the Indian scenario, Swiggy is the only one to register operating profits in two cities, Hyderabad and Bangalore. As a result, it is the only one to receive fresh round of funding.

(ii) Using Innovative Technology to Enhance Service Quality : Making appropriate investment in technology upgradation with a focus on deeper vendor integration can reduce overall delivery time & cost and can enhance customer experience. Swiggy is the only player in this segment having its own fleet of delivery personnel equipped with smart phones and powered by complex routing algorithms which has panned out positive results in terms of shorter delivery time of just 25-30 minutes and enhanced customer experience.

(iii) The Indian Market : Given the availability of cheap labour, most restaurants in India can afford their own

delivery personnel, thus eliminating the need for additional delivery service. On this premise, it is imperative that food delivery companies need to carefully build on unique propositions for both the customers and their partner restaurants. For example, Swiggy has launched in-house cloud kitchen platform as well as the option for customers to pre-order meals to cater to evolving habits & customer preferences. Also, since food delivery business is hyper local in nature, factors such as the infrastructure challenges, demographics of the place, discretionary spending pattern, and rate of adoption of the service are determinants of success in India.

Conclusion

The significance of the E-commerce platform in the Internet boom era as a means for online ordering and food-delivery cannot be ruled out. However, Indian food delivery start-ups may not be able to script great success stories alike Grub-hub in the U.S. and JustEat in UK in the near future. The current phase of correction is bound to weed out the startups without intrinsic value and create space for viable startups to grow. The survivors may have to tweak their business model wisely to suit the Indian market. The prime focus will be to offer unique value proposition to customers and restaurants.

Going by what has been happening so far in the Indian food-tech space, it seems that the price cannot be the only criteria for differentiation in the food tech space. The food delivery companies need to carefully build on unique propositions for both the customers and their partner restaurants. Providing a variety in products offerings, reliable and timely delivery, ease of ordering and other service parameters can certainly go a long way in acquisition and retention of customers.

(i) Channel Power and Network Effect : The sustainability of the food-tech business can be examined through a comparison with the hospitality industry where online intermediaries like MakeMyTrip, Airbnb, etc are exerting considerable channel power. A customer books a hotel or travel service online due to convenience, time saving, and cheaper price offered by them. As more number of customers adopt the online channel, a network effect is created, thus eliminating the traditional offline agents and has compelled hotels and other service providers to register as partners with these intermediaries. While the core proposition of food delivery companies remains convenience for customers, food delivery startups need to go beyond and deliver quality food which unfortunately they can't influence. Being perishable, rapid delivery, and careful control of temperature and other conditions during transit also have to be ensured. Thus, for packaged goods, there will be a real and significant fixed cost per delivery. Without a sufficient number of products to offer economies of scope, distribution costs will be extraordinarily high and will reduce or eliminate consumer adoption of this new channel, unless the channel operator is willing to sustain large losses by subsidizing logistics ("Changing channel distribution models in the Internet age," n.d.). This is what is happening in the food delivery space in India today.

(ii) Three Big Players Can Survive : In competitive, mature markets, there is only room for three full-line generalists along with several (in some markets, numerous) product or market specialists (Sisodia & Sheth, 2002). Full generalists compete across a range of products ; whereas, product specialists and market specialists focus on specific product or specific market. The full line generalists are volume players, whereas the product and market specialists are margin players. The food tech space in India too will evolve in a similar pattern. The generalists who are unable to capture a sizable share of the market may be taken over or evolve into product or market specialists. Alternatively, specialists can be sold out to generalists. To draw an analogy, the takeover of Myntra by Flipkart in the e-retailing space is a useful example. In the food tech space in India too, mergers and acquisitions are on the rise and a similar pattern is expected to emerge.

Limitations of the Study and Scope for Further Research

The present research is not free from limitations. The time frame of the research is restricted from the inception of food tech companies to March 2016. With new developments happening every month, the scenario in the food tech space is changing at a rapid pace and so does the applicability of the research conducted. The present research considers only players in the restaurant food delivery space. There are other players in the food tech space with different business models such as those which facilitate restaurant search & discovery, only ordering, and ordering+delivery+cooking. They have not been considered for the present research.

Further research is required to explore the sustainability of other variants of business models in the food tech space. The food delivery business being hyperlocal, research specific to geographic regions can be conducted.

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