Groupon

Does a Social Commerce Superstar Have a Competitive Advantage?

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In June 2011, when Groupon filed for its initial public offering, it was called it “the cool new kid on the tech block,” and “the fastest growing company in history.”

Groupon was one of a rising generation of internet superstars that were based on social networking. These “Web 2.0” companies, including Facebook, LinkedIn, and Twitter, used the internet in a new way, not just to publish information in a different medium but to create a business based on user-generated content.

Groupon, whose name was formed by combining “group” and “coupon,” was a “daily deal” website for local businesses. The company advertised one deal a day in each city and recruited large groups to purchase products and services at a discount. (See Exhibit 1.) Businesses were delighted by the surge of new customers who came through their doors overnight. Customers were delighted by the discounts they were able to receive through the power of group buying.

The idea had excited a great deal of interest among investors. Groupon had expanded at an amazing pace, growing 1,475 percent in first-quarter revenue between 2010 and 2011. It had attracted substantial valuations, and in 2010 it had turned down an offer from Google for $6 billion. Then in June 2011, only three years after its founding, Groupon filed for an IPO, which was rumored to value the company at $20 billion.

In spite of the company’s meteoric rise, not all analysts were persuaded that Groupon was a buy. One commentator said, “... this isn’t the slam-dunk that many fans and investors were hoping they would be getting.” Another observer warned, “We are totally partying like it’s 1999 again.”

These analysts had good reason to be cautious. At the time of the IPO, Groupon was $230 million in debt. It was also facing heated competition from numerous rivals: some 500 similar sites around the world peddled daily deals from local merchants, including the large and growing U.S. company LivingSocial. Even Groupon CEO Andrew Mason, in a memo to employees, confessed to being intimidated: “If you feel a little like Frodo climbing Mount Doom, you can’t be blamed.”

At the time of its IPO filing, Groupon held the lead among group buying sites, a 52-percent market share of revenue generated, according to the group-buying site aggregator Yipit. But many questions remained about its future. Would Groupon’s labor-intensive business model prove profitable? Would customers and merchants be loyal to Groupon? Would other companies take its business? In summer 2011 it was far from sure that the young company could maintain its lead.
Coupons and Group Buying Background

Coupons began in 1888, when Asa Candler marketed his new Coca-Cola drink by distributing cards entitling the holder to receive a free glass of soda. (See Exhibit 2.) The success of the experiment inspired C. W. Post to use coupons to sell breakfast cereal, and then, during the early decades of the 20th century, coupon use became widespread in the United States. Thrifty housewives clipped coupons from magazines and newspapers and used them in their weekly grocery shopping to buy their favorite name-brand products at a discount.

Over time, coupons became an important way for companies to market their products, particularly consumer packaged goods. In 2010 over 300 billion coupons were distributed in the U.S., and the value of coupons redeemed for consumer packaged goods amounted to $3.7 billion. (See Exhibit 3.)

During the 1990s, coupons migrated to the internet; buyers might either print them out and take them to a store, or use a coupon code to obtain a discount from an internet seller. With the search capabilities of the internet, new coupon aggregators helped consumers find the best deals.

The 1990s also saw the beginning of internet group buying. One of the most notable websites, Mercata, an online company backed by Microsoft founder Paul Allen, helped consumers organize to buy merchandise at a volume discount. However, Mercata had trouble attracting businesses, because they feared alienating existing customers who were not getting the lower prices. The company also had trouble attracting customers, because it could not compete with the discounts and service offered by the new Amazon.com. When the dot-com bubble burst in 2001 and the economy slowed, Mercata ceased operations.

During the mid-2000s, new ways of using the internet were developed. The first generation of the worldwide web, which lasted from about 1993 to 2003, had featured static websites; essentially it was publishing transferred to a new medium. The second generation of the internet, known as “Web 2.0,” allowed users to create the content of a website. Blogs featured constantly updated comments from readers. Facebook and Twitter depended entirely on content posted by members. Linden Lab’s Second Life and Zynga’s Farmville organized social networking friends to play elaborate online games.

Another component of web 2.0 was the development of social commerce sites, which mixed shopping with social networking, games, and entertainment. Social commerce went beyond the publication of customer reviews to use social media for commercial purposes. One of the earliest and most successful of these sites was Groupon.

Groupon History

In 2007, Andrew Mason, a graduate student at the University of Chicago, founded a website called The Point to organize social campaigns such as fundraisers. Visitors to the site would pledge to give money or take action, but the campaign would happen only if a certain number of people agreed to participate. The goal, according to the website, was to “ask people to act when it actually makes a difference.”

Mason was having trouble monetizing the site, and at the same time he noticed that one of the most popular uses of the site was to organize group buying. In November 2008 Mason spun off Groupon to apply the “tipping point” technology of The Point to group buying. Groupon recruited local merchants in the Chicago area to sell gift certificates at a deep discount—for example, a $30 dinner for $15—but the certificates would become valid only if a certain number of buyers agreed to purchase them. Groupon publicized the deal and recruited customers to commit to buying the vouchers. Customers benefited because they received goods or services at a volume discount; merchants benefited because they received advertising and an influx of new customers.
In the midst of a recession, the new service found an eager reception from consumers and businesses. By the beginning of 2009, the company was selling up to 300 “Groupons” a day in the Chicago area, and over the next several months it expanded to other cities.

Then, over the next two years, the company enjoyed huge growth. Between June 30, 2009, and March 31, 2011, Groupon expanded from about 150,000 subscribers and 200 merchants in five North American markets to 8.3 million subscribers and 57,000 merchants in 175 North American markets. (See Exhibit 4.) During the second quarter of 2009 Groupon sold some 116,000 deals for revenues of $3.3 million; by the first quarter of 2011 the company had sold 28.1 million deals for revenues of $664.7 million. During the same interval, its workforce expanded from 37 to over 7,000 employees. (See Exhibit 4 and Exhibit 5.)

In addition to expanding internally, beginning in May 2010, Groupon also made 13 acquisitions of international partners, including Gaopeng.com in China; CityDeal in Europe; and firms in Israel, India, and South Africa. By 2011 Groupon was operating in 43 countries.

In April 2010 Groupon sold a five percent stake to Russian company Digital Sky Technologies. In November 2010 Google offered $6 billion for the company, but Groupon turned it down, and in January 2011 Groupon raised $950 million in venture capital financing. In June 2011 Groupon filed to go public. Analysts speculated that the IPO could seek to raise $1 billion, which would value the company at $20 billion.

**Groupon Business Model**

The mission of Groupon was to connect local businesses with customers.

Traditionally, small businesses relied on advertisements in various media to bring in new customers; in 2011 local business ad spending in the U.S. was expected to be $15 billion. However, it was difficult for these merchants to judge the return on their investment: they never knew if a new customer learned about the business through word of mouth, a newspaper ad, or the yellow pages. In addition, small business owners might not have marketing expertise, and many did not have the time to create and maintain a high-level web presence.

Groupon’s goal was to help local merchants use internet technology to acquire new customers in a sure and measurable way. As the company’s prospectus put it, “By bringing the brick and mortar world of local commerce onto the internet, Groupon is creating a new way for local merchants to attract customers and sell goods and services.” The goal, according to CEO Andrew Mason, was to become the Amazon.com of local commerce, “…doing what the Seattle-based online retail giant has done for products: creating an incredibly efficient …way for merchants to reach new customers.”

**Merchant Experience**

Groupon attempted to minimize the risk for the small business. Sales representatives worked closely with the merchant to arrange a daily deal. A price was set; for example, $15 for $31-worth of airport parking services. A tipping point was set; for example, the deal would only happen if 20 customers signed up. A deadline for committing to the deal was also set; for example, the deal would be offered for three days, although it was featured on the home page for only one day. Groupon writers described the particulars of the deal, including any expiration date and other restrictions. Groupon then chose a day and advertised the deal. (See Exhibit 1.)

The merchant paid no money up front. Groupon collected the customer payments and then split the voucher revenues with the merchant, with Groupon getting anywhere from 30 to 50 percent. The merchant was paid in three installments 5, 30, and 60 days following deal day. Merchants outside the U.S.
were paid only for vouchers that customers redeemed. By law U.S. merchants were paid for all vouchers purchased. Redemption rates were upwards of 90 percent, and both Groupon and the merchant kept the money from any unclaimed vouchers. However, some states considered the vouchers to be like gift cards, and they prohibited expiration dates.

**Merchant Acquisition**

Groupon’s sales force prospected for deals at local businesses. A large portion of its deals were for restaurants or health and beauty services. Groupon also promoted activities and events, such as horseback riding lessons and concerts, but few offers were for retail products. (See Exhibit 6.)

Merchants signed exclusive contracts for a certain time and agreed to allow Groupon the discretion to decide whether to offer the deal, and when. Groupon maintained a “merchant pool” of committed deals, so that it could maximize the variety and profit of its deals in each market. As of March 31, 2011, the merchant pool was 40,000. Groupon had to maintain a delicate balance: in order to please its merchants, it needed to restrict the size of the merchant pool and launch each deal with a minimum of waiting time, but in order to please its subscribers, it needed to offer an interesting variety of deals from high-quality establishments that subscribers wished to patronize.

Over the two years of its operations, its sales force productivity had nearly doubled, from $87,000 average revenue per representative per month to $172,000 average revenue per representative per month. The number of merchants each representative secured had also increased dramatically, from six per representative in the first quarter of 2009 to 17 per representative in the first quarter of 2011.10 Groupon booked revenue as the face value of the coupons it sold. It booked gross profit as that revenue minus the amount shared with the participating merchant.

**Value Proposition to Merchants**

Groupon provided a sure way for a merchant to bring in customers. Businesses looked forward to deal day, and they eagerly watched the Groupon website to see how many subscribers were signing up. Many merchants were astonished by the response to their offer: with no up-front investment, a small business might see its customer traffic multiply tenfold or more. Satisfied business owners spoke of the surge in morale that came from seeing so many new faces come in the door. One fitness center owner said that her Groupon offers increased gym membership from 20 to 500. Businesses also found that phone calls and traffic to their website increased; for example, one merchant said that site visits rose from 100 on a typical day to 4,000 on the day of the deal.

As well as bringing in an infusion of customers, Groupon also provided what it called what it called “efficient, measurable marketing.” As the deal progressed, merchants could use online tools to track the number of subscribers contacted, the number of Groupons purchased, the number of redemptions, the amount spent per redemption, the time of redemption, and basic demographic data on customer gender and age. This data could later be used to target future marketing efforts.

With Groupon keeping up to half of the voucher revenue, businesses did not necessarily make money on a deal. For example, a restaurant might arrange an offer of $10 for $20-worth of food. If Groupon kept $5, the restaurant received only $5 for the meal.

But Groupon claimed that customers would frequently spend more than the voucher value. For example, the prospectus gave an example of a restaurant where “Groupon customers spent an average 68% above the $60 face value of the Groupon, generating approximately $80,000 in gross sales.” Another business owner said that each $30 Groupon sold brought in $65 to his restaurant.11

In any case, Groupon and its satisfied merchants claimed that the service was a cost-effective way to bring in new customers. As one restaurant owner put it, “You get your seats full, you make a little bit of money,
you get good face time with potential clients, which is hard to come by.” Another business owner said, “As far as a one-day return on investment, getting new customers into the store, we’ve never had anything like Groupon.” Groupon claimed that the effect of the daily deal lasted beyond the redemption period of the vouchers. Its customers were not “one-day wonders” but serious shoppers who were likely to patronize the business on a regular basis.

**Customer Experience**

The basic Groupon customer experience was simple. Customers signed up for free membership in a Groupon website in their city. Then each day Groupon sent an email announcing the deal of the day from a local merchant; for example, $40 for a personalized acupuncture treatment, which normally sold for $120. Interested customers committed to buying the deal, but their credit cards would be charged only if the deal tipped and the minimum number of customers was recruited. Once the deal was on, the customer could print out a voucher and take it to the local business to be redeemed.

Groupon attempted to provide deals only with “top-rated business partners” so that its customers would feel comfortable venturing out and trying something new—just because it’s featured on Groupon. It committed to making the deal simple to understand, and its home page displayed the “Groupon Promise” guaranteeing a refund if a customer ever felt “let down.”

During the early days, Groupon depended on its members to spread the word about a deal in order to reach the tipping point, but as its subscriber base grew, daily deals were typically fulfilled soon after they were posted.

**Customer Acquisition**

Groupon’s marketing staff recruited subscribers through internet advertising; referral and affiliate programs; traditional advertising on television, billboards, and radio; and sponsored events. In 2011 the company spent $3 million purchasing commercials aired during the Super Bowl.

Groupon believed that its marketing money was well spent: according to the prospectus, in the second quarter of 2010 the company spent $18 million on online marketing expenses in North America, and over the next year it generated $61.7 million in gross profit from this group of subscribers.

Groupon also benefited from word-of-mouth advertising by happy customers. According to the prospectus, “A benefit of our well recognized brand is that a substantial portion of our subscribers in our established markets is acquired through word of mouth.”

**Target Audience**

Groupon prided itself on reaching a “savvy young audience.” According to Andrew Mason, “We built Groupon for people who are like us: young people, web-savvy, living in the city, maybe a little overwhelmed by the amount of choice out there, and looking for a good reason to try something new.” Its most loyal subscribers were urban, college-educated single women with money to spend.

Groupon saw itself as offering something more glamorous than a dollar off a breakfast cereal. “They look to us because they want to get up off their couch and do something, whether at a restaurant or skydiving,” said a Groupon spokeswoman. Groupon was the place to go for savings on high-end services such as museum memberships, pedicures, or sushi restaurants; it generally did not offer deals with bus companies, liquor stores, or furniture rental services.
Customer Community

In order to connect with its “savvy young audience” and generate customer loyalty, Groupon attempted to create an online community. Groupon went to great lengths to cultivate a relationship with its subscribers through the quirky personality of the “Groupon narrator,” which one employee described as “an unhinged professor” writing “absurdist poetry.” For every daily deal, Groupon’s editorial staff wrote a product description that began with an offbeat opening; for example,

A good state landmark preserves history by displaying authentic artifacts that show how people lived in earlier times, how they cooked, and what sitcoms they frequently quoted. Enjoy edifying conservation with today’s Groupon to Connecticut Landmarks….

For customers who wanted more of the unhinged professor, a whimsical “Groupon Says” essay with its own cult following provided daily advice:

The Groupon Guide to: Summertime Drinks

Though winter is perfect for warm drinks such as hot chocolate and room-temperature breakfast creams, summertime is meant for icy, cooling concoctions. Here’s a look at the most popular summertime drinks:

**Lemonade:** Buy it from a neighborhood child—if you don’t mind destroying our economy by frequenting unlicensed, roadside “businesses” that don’t pay taxes.

**Sun Tea:** Like every food, tea should be left in the sun for a few hours before enjoying it.

**Arnold Palmer:** Created by the legendary golfer, this refreshing beverage is a daring mixture of Coke and Pepsi.

**Aloe:** This is your cool, thirst-quenching reward for eating your way through a cactus.

**Boiling Water:** Cool off on a hot day by equalizing internal and external temperatures. As a bonus, your organs will become completely sterilized.

Subscribers could post their responses to the essay on Groupon’s “feelings board.” Responses ranged from puzzlement—“I can’t figure out if this … tip sheet is supposed to be humorous or informative”—to anger—“COME ON Groupon—THERE IS SOOOOO MUCH DIS-INFORMATION OUT THERE”—to complaints—“The Town Pub in Tonawanda is the worst restaurant I have ever had the displeasure of eating at.”

Criticisms of the Business Model

Not every local merchant was a Groupon convert. One restaurant manager in New Haven said that she had no interest in trying a daily deal program, even though other business owners in town were convinced that it was the wave of the future. “I don’t want to have one customer in here paying half price and another customer at the next table paying full price,” she said. Her business already had its own email list of loyal patrons, who were contacted with special offers during slow periods.

Groupon also had some dissatisfied clients. There were some anecdotal accounts of businesses being overwhelmed with too many customers, resulting in frustration for employees and regular customers. Some merchants complained that Groupon customers were stingy, spending only the value of the voucher, or that they had trouble getting Groupon customers to come back. On the other hand, some Groupon subscribers who purchased a daily deal came away disappointed in the quality of the product or service. Other subscribers found that their Groupons expired before they could use them.

A more methodical academic study of a number of daily deal sites published by Rice University in June 2011 suggested dissatisfaction with the business model. According to the Rice study, only 55.5 percent of
merchants made money on daily deals, and only 35.9 percent of customers spent beyond the deal value. Perhaps as a result, less than half of businesses were enthusiastic about running another daily deal.

Still, many merchants found that a Groupon offering was cheaper and more effective than print advertising. As CEO Mason summarized it, “...for the first time merchants are able to get customers in the door without the risk of putting money up front, and for a much lower cost of customer acquisition than anything else.”

**Groupon Operations**

Compared to other internet companies, Groupon’s business was highly labor-intensive. It depended on a large staff to recruit merchants and subscribers, write appealing advertising copy, provide customer support, and design and maintain the websites. (See Exhibit 7.)

As of March 31, 2011, Groupon had 7,107 employees serving 83 million subscribers and 57,000 merchants. In contrast, Facebook had 2,000 employees serving 750 million members. Groupon’s revenue per employee was low, only about $107,000 compared to approximately $1 million for internet companies Google, Amazon, and Facebook. (See Exhibit 8.)

In its North American and international offices, Groupon had 961 corporate employees. Its main executive offices were located in Chicago and Berlin.

**Operations Staff**

Groupon’s prospectus divided its operational staff into five core functions.

A staff of 410 city planners identified potential merchants in a particular market and scheduled the deals to maximize quality and variety, and to meet profit and marketing goals.

Groupon’s staff of 925 editors and writers wrote the descriptions that introduced the deals on the website. According to an article in *The New York Times*, their starting salary was $37,000.

Groupon’s staff of 277 merchant reps worked with the merchant before, during, and after the deal. They helped the merchant to prepare for the influx of new customers and provided analytics measuring purchase traffic and demographic information on purchasers.

A staff of 825 customer service reps received feedback by phone and email and worked with the technology team to improve the customer experience on the website and mobile applications.

A technology team of 253 developed and maintained the Groupon website and other systems for internal use.

**Sales Reps**

Groupon had 661 sales representatives in North America and 2,895 in its international segment, for a total of 3,556. Sales reps were paid base salaries of about $37,500, plus commissions.
Groupon Product Innovation

Groupon began by offering one deal a day in each city, but it soon added variations on this theme.

Deal Channels, introduced in Feb. 2011, aggregated daily deals from the same category, such as home and garden, events, and travel. Personalized Deals were based on age, buying history, and other preferences. GrouponLive, a partnership with Live Nation Entertainment, offered coupons for concerts and other live events.

Although it worked primarily with local businesses, Groupon also had run a few promotions with national advertisers. In March 2011 Groupon partnered with Lionsgate Studio to sell discounted tickets to the opening showings of a new Hollywood movie. It tried deals in partnership with national chains such as ZipCar, Whole Foods, and Barnes & Noble booksellers.

Groupon Stores

In fall 2010 Groupon began testing a self-serve deal platform, Groupon Stores, which allowed merchants to launch their own deals on a regular basis. Merchants set up an online store, and once they signed up 25 followers, they could begin offering deals. Groupon took a commission of 10 percent on each sale.

Groupon Stores was less profitable for Groupon than its regular deals, and it was also more difficult to monitor the quality of the merchant and the deal. However, the platform allowed Groupon to overcome the limitations of the “daily deal” model and make its services available to any merchant at any time.

Groupon Now

Groupon Now was a new service that allowed customers to find deals on demand in their immediate environs. Subscribers entered their location through their smartphone and chose a type of deal, such as “Eat Something” or “See a Show” or “Take Care of My Car.” Groupon displayed a selection of deals available at that moment; for example, $4 for a $7 breakfast today from 10 a.m. to 11:45 a.m. Then the customer could buy the deal and redeem it immediately, using mobile phone barcode technology. Groupon sent the merchant payment for their share of the vouchers redeemed.

Groupon Competitors

One of Groupon’s greatest challenges was that its business appeared to be easy to imitate; indeed, Andrew Mason acknowledged in late 2010 that “everybody and their grandmother” was starting competing social commerce websites. Barriers to entry were low, and rivals copied not only the daily deal business model but also the website design and writing style. (See Exhibit 9.)

LivingSocial

The main rival to Groupon was LivingSocial, a large deal-a-day site founded in 2009 in Washington, DC. In March 2011 the site gained massive exposure when an offer of a $20 Amazon gift card for $10 brought in 1.4 million buyers. By July 2011 the company had 40 million members in 21 countries, and its market share was growing.

Like Groupon, LivingSocial offered daily deals with local merchants in a variety of markets, and it also offered targeted deals in the categories of escapes, families, and adventures. Like Groupon, LivingSocial was also expanding into “instant” deals that buyers could find in their immediate vicinity by using an app on their mobile phones.
In July 2011 LivingSocial was seeking to raise $1 billion from an initial public offering. It was valued at $10 billion to $15 billion, and its CEO, Tim O’Shaughnessy, was vowing to overtake Groupon by the end of the year.24

**Smaller Daily Deal Companies**

Countless smaller deal-a-day rivals were also threatening to take business from Groupon. Many of these featured special deal structures or were targeted to niche buyers. Some websites, such as Tippr, had “accelerated deals” that grew larger as more people signed up. Other sites, such as Gilt City and Vacationist, had “flash sales” that offered discounts for only a short time.

Targeted deal sites included OpenTable for restaurants; TravelZoo for travel deals; Gilt City for luxury goods; DoodleDeals for moms and kids; Thrillist for affluent men; TeachStreet to help instructors organize classes in subjects such as music, yoga, and SAT prep; and OfficeArrow for business products and services.

**Established Internet Giants**

Other hungry rivals were the internet giants Google, Facebook, eBay, and Amazon. These companies had the customer base and technology to be threats to Groupon, and they were eager to expand their business into the daily deal space.

Google Offers was a daily deal website that imitated the look and feel of Groupon. In summer 2011 it was available in a beta form in just four cities, but it was expanding quickly.

In 2011 Facebook began offering daily deals in some cities, in partnership with existing deal companies, such as Gilt City and OpenTable. Also in 2011, online auction site eBay began featuring “items from some of our trusted sellers who are offering deep discounts” in a daily deal format similar to Groupon.25

Amazon was also entering the daily deal market, both through investments and on its own. In 2010 Amazon acquired Woot, a longstanding daily deal site that specialized in electronic gadgets. In 2011 Amazon invested in LivingSocial and began offering “AmazonLocal” deals in selected cities, including the Groupon headquarters city of Chicago. The company also said it had plans to begin offering its own daily deals independent of LivingSocial.

**Existing Locally Oriented Sites**

Other competitors to Groupon were already-established businesses focused on outreach to local customers. Whereas Groupon was starting from scratch in any new city where it began operations, these rivals had an existing customer base.

ReachLocal was an online yellow pages where local businesses could promote themselves through ads and daily deals. MapQuest, which made its name by producing maps and driving directions online, added a service to allow companies to supplement search results with photos and coupons.

Some locally oriented sites offered apps to enable customers to find instant deals with their mobile devices. Malls, such as the Broadway Square Mall in Tyler, Texas, offered apps to help shoppers find discounts. Yelp, a site aggregating customer reviews of local businesses, had a mobile phone app to recommend businesses based on the location entered.

Most significantly, local newspapers began to add daily deals to their online presence. For example, the *Minneapolis Star-Tribune* offered “Steals from StarTribune,” such as $22 for a wine-tasting event valued at $45. Even the *New York Times* began a Groupon-like service, TimesLimited, offering luxury services...
such as a “VIP opportunity to drive four Ferraris en route to the Pebble Beach Concours D’Elegance event” for $5,995.

In Connecticut, the Meriden Record-Journal’s online publication, MyRecordJournal.com, started a daily deal program in June 2011. Vice President and Associate Publisher for New Media Liz White (Yale SOM ’09) believed that a deal tied to the local newspaper had a number of advantages. With a 144-year history, the Record-Journal knew its readers and its advertisers. It had solid relationships with local businesses and dedicated sales reps who visited them regularly. It was able to reach both print and online readers: the deal was advertised on the website home page and on the front page of the print newspaper. The Record-Journal considered the daily deal program to be just one part of a varied marketing solution, including online ads, newspaper ads, and coupons. According to White,

[We are] transforming from a newspaper to both an information company, where people get our information in all different formats, not just in print, and also into a multimedia advertising solution, where we don’t just offer print advertising anymore. We offer lots of different advertising, which can all be part of the solution for the advertiser.

**Overseas Competitors**

Groupon was not safe overseas, either. Although it had expanded globally by purchasing some of its competitors, many challengers remained. For example, in Korea Ticket Monster had a 50 percent share of the social commerce market and was expanding into Malaysia. In India SnapDeal offered deals in 45 cities. And in China there were 3,500 group buying websites.

**Third-Generation Social Commerce**

An analysis in The Economist suggested that a “third generation” of social buying sites might supplant the daily deal model. These companies integrated commerce with socializing and games.

For example, Lockerz was a “friends with benefits” system that gave “pointz” to members for watching video ads and recommending products to friends. Members could then exchange their points for discounts on products they wished to buy; for example, 50 percent off a hotel room for 500 “pointz.” Another startup, Swipely, published a member’s purchases to their online friends whenever they swiped their credit card and then gave a cash-back reward to the member. The social networking app Foursquare gave rewards and special offers to members who checked into local businesses with their smartphones.

Groupon and its imitators publicized a deal and waited for customers to sign up. But some observers believed that younger buyers might prefer to get their discounts through competitions and social networking rather than a simple deal-a-day program.

**Traditional Coupons**

Finally, Groupon faced competition from traditional paper coupons. In 2009 the United States began experiencing what the Economist called a “coupon renaissance.” In response to the financial crisis, Americans redeemed 3.2 billion coupons, up 23 percent from the previous year, and 88 percent of them were paper coupons printed in newspapers and magazines. In 2010 coupon use rose again, to 3.3 billion redemptions.

Traditional coupons required little up-front investment for either merchant or consumer, and they were more popular for groceries, such as yogurt and cleaning products, than for services, especially the high-end services that Groupon specialized in. (See Exhibit 3.) Still, the continuing strength of traditional coupons caused some observers to speculate that Groupon’s growth might be limited.
Theories of Groupon Advantage

As the clones proliferated, the question was asked whether Groupon could survive. "It’s not clear to me what their defensible competitive advantage is," said one analyst.27 But in spite of the multifaceted competition, at the time of its IPO filing, Groupon held a substantial lead over its rivals, and observers had reasons to believe that it might prevail.

Large Subscriber and Merchant Base

Groupon was the first mover in the online daily deal space, and it had an established infrastructure. With 50 million subscribers, Groupon could deliver the customers to local merchants. With its thousands of support staff, Groupon had the back office capability to recruit merchants and to respond to inquiries or complaints on the part of both subscribers and merchants.

With its large merchant base and its established relationships with them, it could count on a continuous stream of merchants eager to promote their businesses. Groupon boasted that because it had so many merchants demanding to be featured on its site, it could be choosy about its daily deal: "We maintain a large base of prospective merchants interested in our marketplace, which enables us to be more selective and offer our subscribers higher quality deals."28

Quirky Style

Groupon believed that its editorial style was another key advantage, essential to attracting and retaining high-quality subscribers. It told prospective merchants,

> With polished writing and a unique brand of humor, Groupon’s intelligent voice connects with our audience of young, media-savvy professionals in a way that traditional marketing copy cannot. Our editorial integrity gives your business credibility with our readers, building trust with your future customers.29

The Groupon style had its skeptics. One journalist complained about “the painful prose of its assembly-line jokes."30 And as Groupon prepared to go public, another observer asked whether Mason’s pranks were appropriate for a large, publicly traded company:

> Groupon really thrives off of his sense of humor and his sense of absurdity. Their copywriting team, many of whom are comedians and improv actors, really fuse that humor into the site. The question is whether his silliness and some of his antics will resonate with public investors. It’s particularly relevant because there are so many questions around whether Groupon is a legitimate business, whether it can be profitable.31

But Mason remained committed to the Groupon brand: “If you don’t have those moments where you go too far, then you’re probably not going far enough.”32 And in spite of attempts to imitate the style, most significantly by LivingSocial, Groupon believed that its "unhinged professor" identity was not easily copied. "We’re not at all concerned any competitor is going to come in and start writing like us," said Groupon’s editor-in-chief Aaron With.33

Marketing and Business Analytics Tools

Other analysts pointed to Groupon’s extensive merchant services tools, which were unmatched by its competitors. On a separate GrouponWorks website, the company provided online webinars, videos, and checklists to help the business structure the deal and prepare for the day of the feature. Then as the deal unfolded, Groupon’s redemption tracking tools gave merchants data about customers that they could never otherwise have obtained. Some observers believed that these tools were even more important than the deals themselves.
Future of Groupon

At the time of its IPO filing, Groupon had yet to make a profit, and in fact, it was losing money, over $456 million in 2010. (See Exhibit 10.)

Groupon justified its appeal to the public by explaining that it needed to make a high up-front investment in signing up subscribers: “We spend a lot of money acquiring new subscribers because we can measure the return and believe in the long-term value of the marketplace we’re creating,” said the Prospectus.34

However, in 2011 that return was falling: Groupon’s revenue per subscriber was declining, especially in established markets, and the marketing cost to add new subscribers was rising.35 Although the site had 83.1 million members, only 15.8 million had purchased.

Groupon was also coming under fire for its unorthodox performance metrics. In the prospectus the company used “adjusted consolidated segment operating income” to report its income. Adjusted CSOI excluded the cost of acquiring new subscribers, making Groupon look more profitable than it really was. After the SEC raised questions about the metric, Groupon removed it from its revised prospectus.

Some observers, while recognizing Groupon’s impressive growth, sounded the alarm about its balance sheet: “... it’s operating like a Ponzi scheme that needs constant infusions of cash to stay afloat as it’s hemorrhaging money,” said one analyst.36

In the meantime, there were the competitors putting pressure on Groupon’s margins, and a new Yipit website aggregating all daily deal sites to find the best deals. By early September, amid stock market volatility, Groupon was putting its IPO plans on hold.

In the Groupon IPO prospectus, CEO Andrew Mason made the grandiose claim, “Groupon is better positioned than any company in history to reshape local commerce.” Mason and his legion of competitors all saw an opportunity to “create a more efficient local marketplace” by bringing internet marketing to the trillion-dollar local commerce space. Many potential investors agreed and pointed to Groupon and other emerging social commerce companies as one of the few areas of growth in a stagnant U.S. economy.

In late 2010 and early 2011, it appeared that Silicon Valley was entering another boom, based on the innovations of a new crop of social commerce and mobile technology companies. Groupon seemed to be one of the best of those companies, an internet prodigy second only to Facebook and Twitter, Groupon’s young founder was poised to become a billionaire and to create wealth for thousands of employees and investors.

But in summer 2011 many questions remained about the future of the young company. Should Groupon continue its expensive investments in acquiring new subscribers? Should it maintain its labor-intensive “deal-of-the-day” program as its primary offering, or move toward a more efficient type of service? How could it respond to the problem that its business model was easy to replicate? Would Groupon ever be profitable, or would it become, like Friendster and Pets.com, another internet flash in the pan?
Endnotes

1 George Rogers Clark Professor, Yale School of Management.
2 Project Editor, Case Study Research and Development, Yale School of Management.
8 Prospectus, p. 1.
10 Prospectus, p. 76.
15 Prospectus, p. 2.
16 “Who We Are” video, GrouponWorks website, http://www.grouponworks.com/
20 Utpal M. Dholakia, “How Businesses Fare with Daily Deals: A Multi-Site Analysis of Groupon, LivingSocial, OpenTable, Travelzoo, and BuyWithMe Promotions” (June 13, 2011).
25 “What you should know about eBay Daily Deals,” http://deals.ebay.com/?_trksid=p5197.m1256
28 Prospectus, p. 71.
29 GrouponWorks for Business website, http://www.grouponworks.com/editorial
34 Prospectus, p. 7.
Exhibit 1: Typical Groupon Daily Deal, 2011

Exhibit 2: The First Coupon, 1888
Exhibit 3: Traditional Coupon Product Mix
Free-Standing Inserts Distributed in 2010 by Top 10 Product Categories (billions)

<table>
<thead>
<tr>
<th>Product Category</th>
<th>Value (billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pet food and treats</td>
<td>14.9</td>
</tr>
<tr>
<td>Personal care products</td>
<td>14.8</td>
</tr>
<tr>
<td>Household cleaning products</td>
<td>13.1</td>
</tr>
<tr>
<td>Snacks</td>
<td>10.9</td>
</tr>
<tr>
<td>Rug and room deodorizers</td>
<td>10.6</td>
</tr>
<tr>
<td>Vitamins</td>
<td>9.9</td>
</tr>
<tr>
<td>Cough, cold, sinus, allergy</td>
<td>8.4</td>
</tr>
<tr>
<td>Hair care products</td>
<td>7.1</td>
</tr>
<tr>
<td>Yogurt</td>
<td>7</td>
</tr>
<tr>
<td>Soap (bar and liquid)</td>
<td>6.9</td>
</tr>
</tbody>
</table>

Source: Kantar Media

Exhibit 4: Groupon Growth, Second Quarter 2009 to First Quarter 2011

<table>
<thead>
<tr>
<th>Category</th>
<th>Quarter ending June 30, 2009</th>
<th>Quarter ending March 31, 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>$3.3 million</td>
<td>$664.7 million</td>
</tr>
<tr>
<td>North American markets</td>
<td>5</td>
<td>175</td>
</tr>
<tr>
<td>Subscribers</td>
<td>152,203</td>
<td>83.1 million</td>
</tr>
<tr>
<td>Merchants</td>
<td>212</td>
<td>56,781</td>
</tr>
<tr>
<td>Groupons sold in one quarter</td>
<td>116,231</td>
<td>28.1 million</td>
</tr>
<tr>
<td>Employees</td>
<td>37</td>
<td>7,107</td>
</tr>
</tbody>
</table>

Source: Groupon Prospectus
Exhibit 5: Groupon Quarterly Revenue Growth, 2009 to 2011 (millions of dollars)

Source: Groupon Prospectus

Exhibit 6: Groupon Deals by Type of Business

Source: Groupon Prospectus
Exhibit 7: Groupon Staff by Type of Employee
As of March 31, 2011

Exhibit 8: Groupon Users and Employees with Comparisons to Other Internet Giants
2010 Figures

<table>
<thead>
<tr>
<th></th>
<th>Users</th>
<th>Revenue</th>
<th>Employees</th>
<th>Revenue per Employee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Google</td>
<td>350 million</td>
<td>$29.3 billion</td>
<td>24,400</td>
<td>$1.2 million</td>
</tr>
<tr>
<td>Amazon</td>
<td>100 million</td>
<td>$34.2 billion</td>
<td>33,700</td>
<td>$1.0 million</td>
</tr>
<tr>
<td>Yahoo</td>
<td>234 million</td>
<td>$5.57 billion</td>
<td>13,600</td>
<td>$409,558</td>
</tr>
<tr>
<td>Facebook</td>
<td>750 million</td>
<td>$2 billion (estimated)</td>
<td>2,000</td>
<td>$1 million</td>
</tr>
<tr>
<td>Groupon</td>
<td>83 million</td>
<td>$760 million</td>
<td>7,107</td>
<td>$106,936</td>
</tr>
</tbody>
</table>

Sources: Yahoo Finance, Groupon Prospectus
Exhibit 9: Typical Groupon Competitor Sites, 2011
团购 东方美SPA 面部美容套餐
原价：¥780
团购价：¥78

12人已购买

温馨提示
- 快手抽奖，中奖有机会赢取现金红包
- 每日限售，抢完即止
- 使用时间：09:00-20:00
- 预约流程：请至美团页面预约
- 有效期：2014年8月11日-11月11日
- 服务项目：
  - 面部清洁
  - 色调面膜
  - 按摩护理
  - 美容

立即购买
**Exhibit 10: Groupon Statement of Operations**

*In thousands, except share and per share amounts*

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue</strong></td>
<td>$ 94</td>
<td>$ 30,471</td>
<td>$ 713,365</td>
</tr>
<tr>
<td><strong>Cost of revenue</strong></td>
<td>89</td>
<td>19,542</td>
<td>433,411</td>
</tr>
<tr>
<td><strong>Gross profit</strong></td>
<td>5</td>
<td>10,929</td>
<td>279,954</td>
</tr>
<tr>
<td><strong>Operating expenses:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Marketing</td>
<td>163</td>
<td>4,548</td>
<td>263,202</td>
</tr>
<tr>
<td>Selling, general and administrative</td>
<td>1,474</td>
<td>7,458</td>
<td>233,913</td>
</tr>
<tr>
<td>Acquisition-related</td>
<td>-</td>
<td>-</td>
<td>203,183</td>
</tr>
<tr>
<td><strong>Total operating expenses</strong></td>
<td>1,637</td>
<td>12,006</td>
<td>700,298</td>
</tr>
<tr>
<td><strong>Loss from operations</strong></td>
<td>-1,632</td>
<td>-1,077</td>
<td>-420,344</td>
</tr>
<tr>
<td>Interest and other income (expense), net</td>
<td>90</td>
<td>(16)</td>
<td>284</td>
</tr>
<tr>
<td><strong>Loss before provision for income taxes</strong></td>
<td>-1,542</td>
<td>-1,093</td>
<td>-420,060</td>
</tr>
<tr>
<td>Provision (benefit) for income taxes</td>
<td>-</td>
<td>248</td>
<td>(6,674)</td>
</tr>
<tr>
<td><strong>Net loss</strong></td>
<td>-1,542</td>
<td>-1,341</td>
<td>-413,386</td>
</tr>
<tr>
<td>Less: Net loss attributable to noncontrolling interests</td>
<td>-</td>
<td>-</td>
<td>23,746</td>
</tr>
<tr>
<td><strong>Net loss attributable to Groupon, Inc.</strong></td>
<td>-1,542</td>
<td>-1,341</td>
<td>-389,640</td>
</tr>
<tr>
<td>Dividends on preferred stock</td>
<td>(277)</td>
<td>(5,575)</td>
<td>(1,362)</td>
</tr>
<tr>
<td>Redemption of preferred stock in excess of carrying value</td>
<td>-</td>
<td>-</td>
<td>(52,893)</td>
</tr>
<tr>
<td>Adjustment of redeemable noncontrolling interests to redemption value</td>
<td>-</td>
<td>-</td>
<td>(12,425)</td>
</tr>
<tr>
<td>Preferred stock distributions</td>
<td>(339)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Net loss attributable to common stockholders</strong></td>
<td>$ (2,158)</td>
<td>$ (6,916)</td>
<td>$ (456,320)</td>
</tr>
<tr>
<td><strong>Net loss per share</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basic</td>
<td>$ (0.01)</td>
<td>$ (0.04)</td>
<td>$ (2.66)</td>
</tr>
<tr>
<td>Diluted</td>
<td>$ (0.01)</td>
<td>$ (0.04)</td>
<td>$ (2.66)</td>
</tr>
<tr>
<td><strong>Weighted average number of shares outstanding</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basic</td>
<td>166,738,129</td>
<td>168,604,142</td>
<td>171,349,386</td>
</tr>
<tr>
<td>Diluted</td>
<td>166,738,129</td>
<td>168,604,142</td>
<td>171,349,386</td>
</tr>
</tbody>
</table>