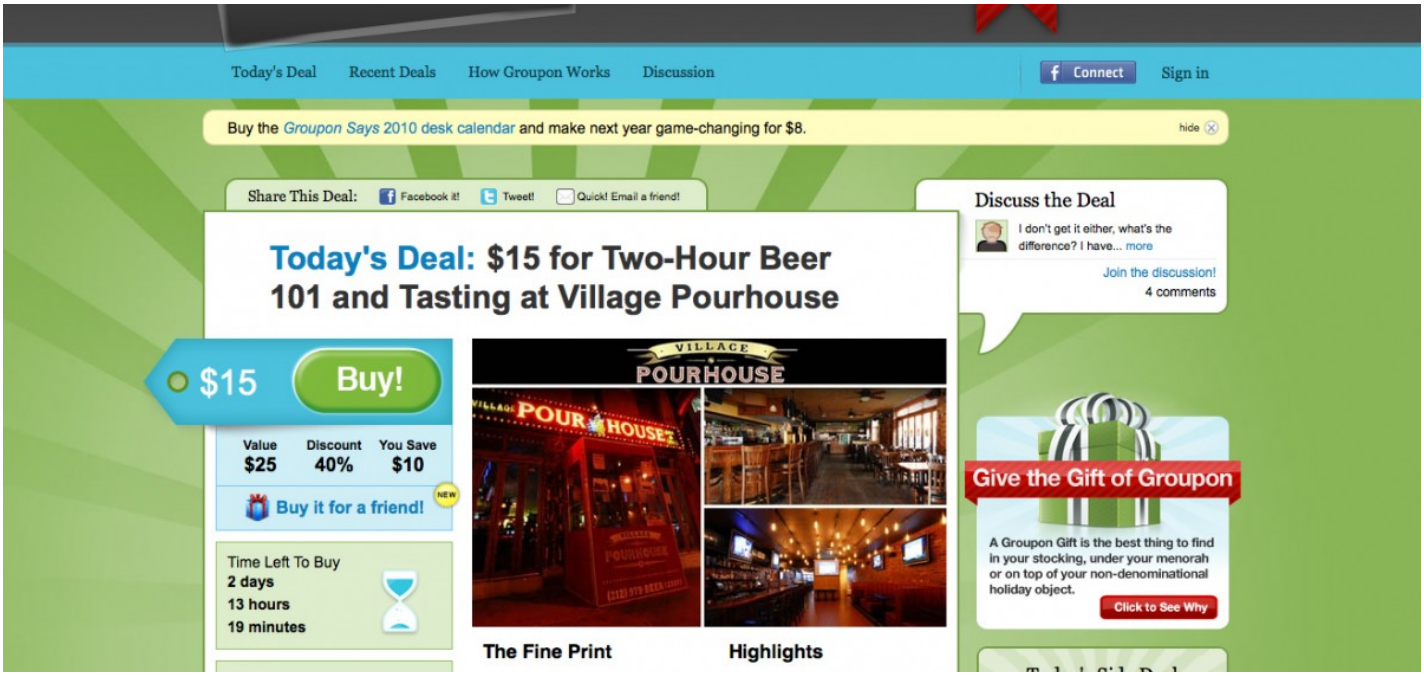
The Groupon Movement | Advantage 2 Retail



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Why You Should Think Twice Before Jumping On Board

About the Author and Introduction

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James Dion, an internationally known Retail Speaker and Author, sensitive to cultural and global issues, offers insight on the impact of the Groupon Movement.

Many retailers across the US have been experimenting the wave of social group buying. This wave is now entering the Canadian retail market. You can now find social group deals from retailers of hard goods, services and apparel in major Canadian cities with a slow start in the province of Quebec. As a retailer, you may have asked yourself if this Groupon Movement can help increase your sales and expand your customer base. In this article, James offers his insights on social group buying from a consumer and retailer's perspective.

WHAT IS IT?

Groupon.com is a deal-of-the-day web company that purports to help connect local merchants/retailers and 'social' consumers. It is essentially a form of local targeted marketing and a good example of how location-based applications can tie local businesses to local customers. End of the good news! Well, there's actually more, but not much.

HOW DOES IT WORK?

Groupon, as the name says, combines the power of a 'group' and the appeal of a 'coupon.'

The idea is to offer highly discounted deals (the 'coupon') via email to subscribers – one a day, every day, the deal is valid for no more than 24 hours – and only grant those deals if there is a minimum number of people (the 'group') who commit to them ('It's a cents-off coupon married to a Friday-after-Thanksgiving shopping frenzy' as one pundit noted).

Groupon relies on word-of-mouth and social media for the success of each deal. Forwarding emails every morning with the latest deal has become a social networking routine amongst social shoppers and that is what makes Groupon so unique: the fact that it is social. You are encouraged to share your bargain with friends on Twitter or Facebook and you are rewarded for referring a friend with $10 Groupon Bucks if they buy a Groupon deal. In essence, you are able to not only share discounts, but also tell everyone about that wonderful restaurant where you had that half price dinner or the yoga class deal that you just signed up for thanks to Groupon. It is all about sharing.

WHO ELSE IS DOING IT?

Many others: LivingSocial.com, Tippr.com, 8coupons.com, to name a few. As a matter of fact, Groupon is getting a lot of competition from upstarts all over the world. However, with $135 million in funding and the advantage of being the first, Groupon appears to have little to worry about at this moment.

WHY IS IT SUCCESSFUL?

Sense Of Urgency/Instant Gratification. Psychologically, sites like these hit us right where it counts, in the immediate gratification, urgency and impulse areas of the brain. Limiting each deal to a single day, and counting down the hours and minutes left, prompts us to Act Now! (you have only so many hours before this offer expires). The combination of a seemingly incredible discount with the short time frame for decision acts to short circuit the normal cognitive process and leads us to conclude 'this is too good to pass up and it's not a ton of money anyway'. This is the key driver and one that brick and mortar stores are starting to pay a lot of attention to and trying to replicate. For example, in late October and early November, Limited Stores offered a 40 percent discount that lasted 8 hours starting at 10 p.m. on Halloween; Bebe Stores Inc.'s 20 percent discount was available for five hours on the following Tuesday. And Talbots Inc.'s 30 percent deal on outerwear on Oct. 20 was even shorter, encouraging shoppers to "take a three-hour lunch."

Exclusivity and Self-Esteem. Add in the aspect of exclusivity, and online companies like Groupon manage to make us feel a little special. By signing up, it feels like you have done something clever, you are 'in the know', and you are going to get something good. Way to go! Feel good about yourself and enhance your self-esteem.

Compelling money-wise. This is the key reason for success: the deals themselves are very compelling. They must offer substantial savings – enough to encourage an otherwise careful budgeter like Jennie Vinson to buy laser hair removal treatments. "I've always been curious, but I wasn't about to spend $750," said Vinson, 32, from Portland. "At $99? Why not?"

It does speak to our collective lust for low prices: "In a market awash in increasingly similar – even identical – goods, price is the ultimate arbiter, the lower, the better" as, Ellen Ruppel Shell author of Cheap put it. (More on consumers' addiction to low prices and how to combat that in one of our future articles).

Just for fun. Why not spend $99 on a laser hair removal treatment? Well, maybe because you don't need it, no matter what the price! For many customers, buying – getting the deal – is more important (read fun) than actually owning the product or enjoying the service (that's why so many deals go unclaimed). People will often spend more than the value of the Groupon voucher. If it's a restaurant, you still have to pay for tax and tip (and often alcohol) and Groupon strongly suggests that you tip on the original price of the meal not the discounted price. So, was it really a good deal, after all?

Ease of use. Signing up to receive Groupon daily deals is free of charge and it is incredibly simple. Then, after you have signed up, once a deal is posted at midnight and is waiting in your inbox when you wake up, you can purchase the coupon, which often provides a 50% or greater discount off the face value of the goods or service being offered that day. There is often a minimum number of customers required for the deal to be "on". So if you are really eager to get that deal, you start sharing it with your friends on social networking sites thus increasing your chances to get it. It is all very, very simple and addictive.

By the way, if you are wondering about Groupon demographics, consider that, according to Groupon, most users are women (77%), most work full time, and about half are single. About half earn more than $70,000 a year, and 29% earn more than $100,000.

DO GROUPON AND OTHER DEAL SITES MAKE MONEY DOING IT? YOU BET!

Groupon has grown faster than Ebay, Amazon.com, Yahoo, AOL or Google. YouTube was the only company to reach a $1 billion valuation quicker than Groupon, but YouTube did so without achieving profitability which Groupon did in only seven months. According to a defunct web blog, Big Money, Groupon turned its first profit in 2008, the year of its launch, and has since expanded from Chicago to 140 cities around the world. The company has at least 16+ million subscribers, 15+ million Groupons bought so far and about 98 percent of the deals it advertises are successful insofar as they are consummated, if successful from the business who offered them, as we will see, maybe not so much. So it's not rocket science to see why Groupon supplies the basic operating principle for most other group-buying sites out there, such as LivingSocial, Scoop St. and others.

WHAT'S IN IT FOR THE MERCHANT/RETAILER?

Exposure. Since the resulting revenue is not only discounted but shared (typically, 50/50) with Groupon, the retailer/merchant may barely break even on the incremental sales. But it now has customers who might never have thought of patronizing the business. Groupon gets its offers in front of eyeballs by buying ad space through Google and Facebook and via the word of mouth of its +16 million subscribers.

As Rob Solomon, President and COO of Groupon said at a recent Shop.org conference in Dallas "[Groupon] is primarily a new customer acquisition channel… We have come up with a way to use the

Internet to drive offline sales…to get people into brick and mortars."

NO, REALLY, WHAT'S IN IT FOR THE MERCHANT/RETAILER?

Offering a Groupon is a real mixed-bag experience from the point of view of many of the merchants.

Jessie Burke, owner of Posies Cafe in Portland, Oregon, described a Groupon deal that they offered as "the single worst decision I have ever made as a business owner thus far." Burke's contention was that after discounting her goods ($6 for $13 worth of food) and then giving over 50 percent of the $6 to Groupon, she was unable to cover her store's operating expenses with the $3 that she did receive, including employee payroll.

Another example? If you believe what was amply written about the Groupon Gap deal, (which offered a $50 Gap Gift Card for $25), while Groupon earned $4 to $5 million in net revenue, Gap stood to lose about $6 to $8 million in revenue on the deal. And one has to wonder why the Gap needed to raise its awareness at this cost to its business!

Burke and the Gap are not sporadic examples. In a study conducted by Rice University, 32 percent of surveyed businesses reported that their Groupon deals were unprofitable and 40 percent indicated they would not run a repeat promotion through Groupon. True, as Groupon keeps pointing out, their main objective is to act as a new customer acquisition channel for the business and profitability of the offer should be secondary to the customer acquisition and retention. However, there is no proof yet that these businesses actually retain any of the Groupon customers beyond the first deal. Groupon themselves quote a 22% retention rate, which may be somewhat high if you factor in regular customers who purchased the Groupon who would return anyway.

Profit: The Big Loser. Most discount marketing companies require your deal to be at least 50% off your regular price. You have to pay the discount marketing company (Groupon, BuyWithMe, etc.) 50% of the purchase price. So, if you agree to sell a $200 deal for $100, you have to give the marketing company $50 for each deal sold. What is the actual profit margin on this? If your direct cost of sales is at 50%, each deal will cost $50 in net losses. If your deal is extremely popular and you sell 500 units, your total loss is $25,000. Unfortunately, the initial new business generated by the discount marketing deal does not make up for this loss. In order to determine if a deal can be profitable for your business, you need to know your net profit margin. To do this, take your sales less cost of goods sold, and then subtract your operating expenses. Then you compare it to your overall revenue. The formula is: Sales minus Cost of Goods Sold equals Gross profit; Gross Profit minus Operating Expenses equals Net Profit; Net Profit divided by Total Sales equals Net Profit Margin.

For example, if you consider that the average net profit margin for most small service/retail businesses is around 6 percent, at this profit margin, you would have to sell a staggering additional $416,666 in products/services to make up for the loss generated by the previously mentioned discount marketing deal ($25,000 divided by 6%). And to expect that that additional $416,666 in business is going to come from returning deep discount customers is simply wishful thinking.

And if you use the 22% retention number we spoke of earlier, for a deal that sells 500 units, it only translates into a best-case scenario of 110 new customers who, by the way, 100% of the time are accustomed to very low prices and will likely not remain customers for very long at full margin.

Employee Issues. According to Rice's survey, if the workers are happy the promotion was good, if not, it was a bad idea. That's because happy associates make the likelihood of the promotions profitability significantly higher, the survey said. "Because the Groupon customer base is made up of deal-seekers and bargain shoppers, they might not tip as well as an average customer or be willing to purchase beyond the deal. So, employees need to be prepared for this type of customer and the sheer volume of customers that might come through." So the business owner may want to factor in higher wages for employees during the promotion to keep morale high, which then makes the profitability of the deal even more elusive.

The survey also said that the percentage of discount offered and the number of Groupons sold did not predict the deal's ultimate profitability. The percentage of Groupon users who purchased beyond the Groupon's value or purchased again at full price did not have any predictive powers either. So one has to wonder about the core value of the Groupon to any business beyond Groupon itself!

The study also found that Groupon promotions offer the most benefit for businesses when the promotion does not cannibalize sales to existing customers. And salons and spas were most successful among the service businesses in doing this while restaurants were the least successful, likely because many consumers are more prone to regularly visit restaurants than salons and spas which are viewed as more of a 'treat' by the customer than a necessity.

GROUPON LATEST ITERATION: GROUPON STORES & DO-IT-YOURSELF DEALS

Groupon just started a new self-serve product called Groupon Stores that allows merchants/retailers to open virtual storefronts and manage their own deals through Groupon.

Here is how it works. Businesses sign up at the Merchant Center and, once approved, can start offering self-managed deals on their pages themselves or with an additional promotional push from Groupon. Groupon takes a 30 percent cut of the deals it helps to promote to e-mail subscribers or users on homepages, and there are also additional fees for this privilege. However, merchants who decide to do it themselves without Groupon's 'help', only have to pay 10 percent of sales to Groupon. Both options are less expensive than the current 50 percent cut that Groupon takes from most traditional deals. One important thing to note is that businesses are only paid when customers redeem deals, and not at the time of sale. So if, for example, you sell 20 deals that offer $10 for $15 worth of product, but only 15 of those Groupons are redeemed, then you'll be pocketing roughly $135 if Groupon does not promote ($10 sale times 15 redemptions less 10% of the total $150 equals the $135), and $105 if they do ($10 sale times 15 redemptions less 30% of the total $150 equals the $105). Obviously, those figures don't account for the losses associated with discounting goods. For merchants, Groupon Stores eliminate some of the risk factor around featured deals. In this new model, business owners can cap redemption limits on their own deals, eliminating the fear of uncapped deals that could lead to tremendous losses (although you can also cap a current regular Groupon deal). The self-serve model does not provide for a minimum quantity needed, which means that there's no minimum sales guarantee but there is still a time limit which is set by the merchant.

Here is how it could not work for you. The question you need to ask yourself is whether you want to reach Groupon members and whether you want to exchange additional profit-sharing costs for additional exposure.

Deals offered through Groupon Stores will have much less traffic than deals through the regular Groupon program and will likely offer less attractive discounts than featured deals, which means that even if subscribers actually manage to find the virtual storefronts, they might still not find the deal very compelling.

In essence, this model provides low risk (if you budget accordingly and cap deal redemptions), but also likely smaller rewards.

COULD A GROUPON TYPE PROGRAM WORK FOR YOU? WHAT ARE THE ALTERNATIVES FOR YOUR BUSINESS?

In order to conduct a successful social promotion campaign of this kind, the first rule is that you should use promotions for building relationships instead of creating one-time transactions. These one time transactions are kind of like a 'sugar hit' and may make you feel great at the moment, but the coming down can be catastrophic. The second rule, as important as the first one, is that you should not offer discounts on a total bill. A specified discount for various products or services is much better. Choose products and services judiciously so that you can use the promotion to sell items that are not popular, that have the highest profit margin or that you have too many of or don't sell too well. Essentially, do what you have always been doing with promotional markdowns, which is not to promote entire categories but rather specific items. A recent Groupon for Pops for Champagne in Chicago did just that. The deal was for the typical 50% off, but the difference was that it was good only for one person and you could not use two Groupons per table. So, how many people are going to go to a Champagne bar alone? Obviously, with the typical couple or even group of four using this Groupon, the bar would likely end up with a very slight overall discount and even possibly gain that elusive new customer that so many businesses are looking for.

Alternatively, you could try to run your own discount marketing deal. You would need to carefully choose what you offer, the price at which you offer it, and how many you offer. The real issue to doing your own 'door crasher' is always how do you promote it. Groupons self-proclaimed edge is the sheer volume of people who subscribe to the site and therefore will see your deal. Currently, beyond blind spam, there is no way to reach that many consumers all at once unless you have a million followers or more on your Facebook page. (The Gap has almost a million)

A great business discount marketing deal could also be something you offer through your existing customers to get their word-of-mouth marketing. This will save money by cutting out the discount marketing company/middle man between your business and new customers.

You could also use tools from sites such as Wildfire or eWinWin to offer group deals via their Facebook Pages. Facebook also recently launched Facebook Deals which allow businesses to run local deals associated with their Places Pages.

Or, you could also experiment with the rewards strategy of location-based services for an alternative approach that focuses on customer retention and location-sharing to expose your business to larger audiences. Consider offering Foursquare specials, Shopkick, or SCNVGR rewards and Gowalla stamps. There is almost no end to the social and geo based network schemes and they are growing every day.

Don't forget the impact you can have on your bottom line if you lower your direct cost from 50% to 35%, as well. You have more room to move on deeper discounts to drive the traffic.

Whatever you do, remember, just offering 50% or 60% or even 70% off to get a short term traffic 'fix' is not a very smart strategy. Think long term, relationship building, and sustainable promotions that excite the customer. More importantly, learn from Apple, it really is about the product. And as a final word, one of the first things that I learned in retail when I was beginning my career years ago, is "Any idiot can give away merchandise, it takes a merchant to sell it". As true today as it was 40 years ago!

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Just before publishing this article on our web site, we read reports indicating that Google would acquire Groupon for $2.5 billion. It will be interesting to see how this will impact both consumers and retailers in the future.

Nonetheless, before you even decide to embark on this movement, retailers should consider their customers' profile and determine if that strategy is appropriate. In most cases, an optimized pricing strategy and a good CRM tool can help retailers achieve better promotional results than a "Groupon" Movement. It goes without saying that leveraging the social networks can definitely help support your marketing efforts without adding too much cost.

A2R consultants can help you determine the optimum pricing strategy and align your marketing efforts in order to grow your business without sacrificing profitability. Ask us how we can help you!

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