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To Groupon or Not To Groupon: A Tour Operator's Dilemma

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Abstract

The case of a tour operator in New York's Finger Lakes region highlights the remarkable potential benefits of participating in a social coupon promotion, as well as the possible pitfalls that require a carefully crafted arrangement. The benefits include participation in an attention-grabbing website (in this case, Groupon) and having many new customers exposed to the business. Possible disadvantages include cannibalizing existing customers, attracting deal seekers who will not become repeat customers, and failing to make up for the revenue forgone when discount purchasers occupy spaces that could have held full-price customers. For the tour operator, Experience!The Finger Lakes (E!FL), an additional challenge was to create a discount package that did not lose money. To alleviate potential issues, the tour operator used a creative approach that involved working with Groupon and participating wineries to add value to the core tour product. By creating a special package, E!FL was able to cover costs, add value for all parties, and offer a different product that was not directly comparable to its core menu of tours.

Keywords

hotels, online booking, online travel agents (OTAs), discounts, social coupon promotions

Disciplines

Business | Hospitality Administration and Management

Comments

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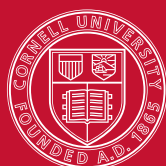


To Groupon or Not to Groupon: A Tour Operator's Dilemma

Cornell Hospitality Report

Vol. 11, No. 19, November 2011

by Chekitan S. Dev, Ph.D., Laura Winter Falk, Ph.D., R.D., and Laure Mougeot Stroock



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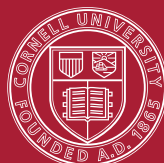
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EXECUTIVE SUMMARY

The case of a tour operator in New York's Finger Lakes region highlights the remarkable potential benefits of participating in a social coupon promotion, as well as the possible pitfalls that require a carefully crafted arrangement. The benefits include participation in an attention-grabbing website (in this case, Groupon) and having many new customers exposed to the business. Possible disadvantages include cannibalizing existing customers, attracting deal seekers who will not become repeat customers, and failing to make up for the revenue forgone when discount purchasers occupy spaces that could have held full-price customers. For the tour operator, Experience!The Finger Lakes (E!FL), an additional challenge was to create a discount package that did not lose money. To alleviate potential issues, the tour operator used a creative approach that involved working with Groupon and participating wineries to add value to the core tour product. By creating a special package, E!FL was able to cover costs, add value for all parties, and offer a different product that was not directly comparable to its core menu of tours.

ABOUT THE AUTHORS

Chekitan S. Dev, Ph.D., is associate professor of strategic marketing and brand management at the School of Hotel Administration. Recognized as a leading authority on strategic marketing and brand management, his award-winning research has been published in several peer reviewed journals, including the *Journal of Marketing* and *Harvard Business Review*. He has won all major hospitality research awards including the 2002 John Wiley & Sons award for lifetime contribution to hospitality and tourism research. A former corporate executive with Oberoi Hotels & Resorts, he has served corporate, government, education, advisory, and private equity clients in over 35 countries on five continents as consultant, seminar leader and expert witness.

These include Accor, Crystal Cruise Lines, Disney, Expedia, ExpoGourmand Chile, Four Seasons Mumbai, French Culinary Institute, Hilton, Holiday Inn, Horwath Austria, HOTUSA Spain, Hyatt, IHRAI Philippines, InterContinental, Jumeirah Dubai, Kerzner Mauritius, Leela India, Mandarin Singapore, Marriott, Moevenpick Switzerland, Orbitz, Peninsula, PlanHotels Italy, Priceline, Rosewood, Sarovar India, Starwood, Taj India,

Travelocity, and Westin. Professor Dev was selected as one of the "Top 25 Most Extraordinary Minds in Sales and Marketing" for 2009 by The Hospitality Sales and Marketing Association International (HSMAI).



Laura Winter Falk, Ph.D., RD, is co-founder, co-owner, and President of Experience! The Finger Lakes, LLC. She has also held faculty positions in the Division of Nutritional Sciences at Cornell as a nutrition researcher, and a project manager for Cornell NutritionWorks, an on-line professional development site. Laura's previous business experience included department and project management, and product development at the CBORD Group, in Ithaca. Laura has a number of peer-reviewed academic publications, and received the Journal of Nutrition Education/Decker Annual Best Paper Award in 2001, and has served as President, and Chairperson for a number of non-profit boards in the Ithaca area

Laure Mougeot Stroock is an independent business research analyst and case writer working for the School of Hotel Administration and the Johnson Graduate School of Management at Cornell University. She previously worked as a research associate at the Harvard Business School and as a consultant for the French nuclear industry. A native of France, she holds a Master of Public Administration from the John F. Kennedy School of Government at Harvard University and a Graduate Degree of International Affairs from the University of Paris IX Dauphine..



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One day in October 2010, Laura Winter Falk glanced back at the cheerful crowd of seven guests sitting in the Experience!The Finger Lakes (E!FL) van as she drove them to the Damiani Wine Cellars, located on the steep hills over Seneca Lake, and producer of well regarded Cabernet and Pinot wines. Ithaca-based E!FL, which she had founded with her husband Alan four years before, was a tour operator offering guided tours and concierge services in the Finger Lakes region. Their new venture was initially so successful that in 2010 the Falks had doubled their capacity by acquiring a second 14-passenger van. However, demand for E!FL tours had begun to taper in 2010, and their second van had been out (and full) fewer times than the Falks had hoped. The spring 2010 season, in particular, had been slow, and the Falks were wondering how to increase growth and revenues. So far, they had relied on their website, referrals, and word of mouth to attract guests. Now, they were wondering whether they should adopt a more aggressive marketing strategy such as signing with Groupon, the online “social coupon” firm which made headlines in 2010 as the “Next Web Phenom,” for growing from zero to a \$6 billion valuation within 24 months.¹

¹ Christopher Steiner, “The Next Web Phenom,” *Forbes*, August 30, 2010, pp. 58-62.

In February 2011, the Falks contacted Groupon, which had just entered the Syracuse market not far from the Finger Lakes in upstate New York, to explore the possibility of having E!FL featured as the deal of the day. The Falks initially were pleasantly surprised when Groupon, which was known for being selective, chose their proposal. But they found it difficult to craft a discounted tour that met the Groupon requirements, preserved E!FL's bottom line, and ensured continuing good relationships with their winery partners. Now, with only a few weeks left before the touring season would begin, the Falks, who were not entirely satisfied with the Groupon deal they had negotiated, had to decide: should they or should they not Groupon?

Experience! The Finger Lakes

Changing Lifestyle Leads to a New Business

E!FL was founded 2007 by Laura and Alan Falk who owned and operated the business. Both had lived in Ithaca, located at the southern end of Cayuga Lake, for over 25 years. Alan worked as a software engineer and Laura first was a manager in a software company, and then was a nutrition researcher at Cornell University (Exhibit 1).

The idea of changing careers came during the six-week sabbatical break that Alan's company offered every four years as a perk for its employees. That summer, Laura and Alan took a three-week RV family trip with their two children in Grand Teton, Yellowstone, and Glacier National Parks. To plan the trip, they searched the internet and hired a small Colorado-based firm that specialized in travel planning for family vacations and RV camping. After discussing the family's trip preferences over the phone, the company sent them a thick personalized binder with RV, campground, and guided tour reservations, as well as a detailed itinerary pointing out worthy stops along the way, such as best restaurants, ice cream shops, and attractions.

"This binder became our bible for the next three weeks, and it dawned on us that this was something we would enjoy doing in the Finger Lakes, where no such services existed," Laura said. In fact, although the Finger Lakes could boast many attractions—lakes, waterfalls, gorges, and wine and culinary experiences, and although these attractions were all featured in local tourist websites² and visitors bureaus, visitors were mostly left to their own devices to organize their journey in the region. "Touring in the Finger Lakes is like being a student at Cornell, everything is decentralized, you can have a wonderful experience but you have to figure it out by yourself," Laura quipped.

² For example, the Finger Lake Tourism Alliance Website (<http://www.fingerlakes.org/>) or VisitFingerLakes.com (<http://www.visitfingerlakes.com/>).

EXHIBIT 1

Short biographies of E!FL executives

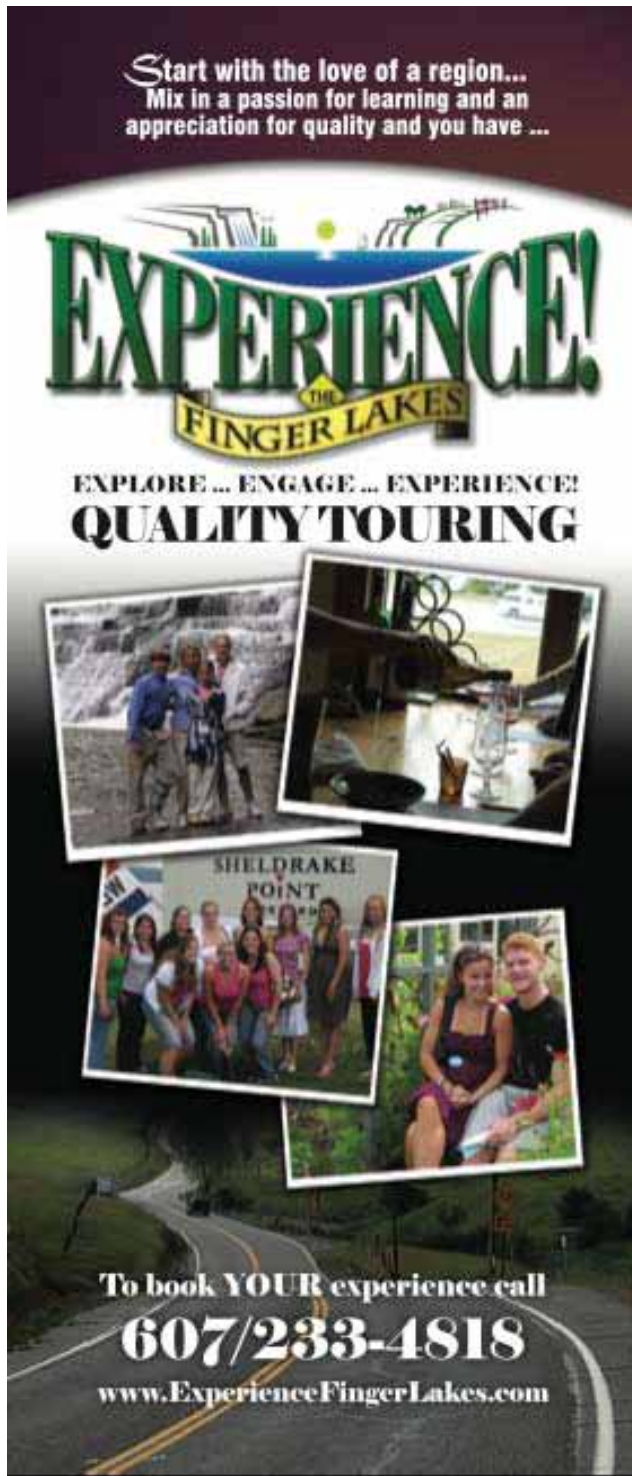
The principal officers and managers are Alan D. Falk and Laura Winter Falk. Alan Falk, CEO, has been living in the Finger Lakes region for more than 20 years. Before starting the company, Alan worked in the software industry in multiple capacities including operations management and project management. Laura Winter Falk, president, has also been living in the Finger Lakes for over 20 years. Laura's past roles and experiences included working as department director for a mid-sized software company, managing a number of start-up products and businesses, and serving as president of the Board of Directors for a non-profit local school. Laura also holds a Ph.D. in nutrition and works as part-time contract researcher at Cornell University.

The Concierge Concept

Back in Ithaca, the couple set out to implement their vision to become a tour operator offering concierge services that would provide their Finger Lakes guests maximum enjoyment with minimal effort. "From the outset, we knew that the Finger Lakes did not offer the same potential as the National Parks. Therefore to make a living, we had to offer more than just itineraries; we would propose all-inclusive tours that encompassed the various attractions of the Finger Lakes: wineries, gorges, history and museums, dining, outdoor recreation, and agriculture," noted Laura.

In late August 2006, Laura and Alan visited the Ithaca Visitors Bureau, which confirmed that no similar services already existed in the area, although limousine and bus companies offered transportation to the various wineries along the four Finger Lakes wine trails. "There was nobody providing full service planning and touring for visitors to the Finger Lakes. There had been some independent tour guides in the past, but apparently they were individuals who worked other jobs and did touring on the side, and eventually discontinued doing it," Laura and Alan were told. To validate further the appeal of their touring concept, Laura put together a small questionnaire for people who walked into the Ithaca Visitors bureau. Out of the 100 sur-

Experience! The Finger Lakes® brochure



veys that she collected over three days, over 75 indicated that they would be interested in a tour.

At the end of August 2006, Alan gave his company his two-months notice and the couple spent the following three months developing their business plan. “Both Alan and I had prior experience in start-up businesses through our former jobs, but all the same Alan enrolled in an entrepreneurial training course at the Alternatives Federal Credit Union to validate our business plan and work on the accounting part,” noted Laura.

Following the advice of their hospitality branding expert friend (and case coauthor) Chekitan Dev over drinks one evening in late 2006, the Falks picked the name “Experience!The Finger Lakes” to convey the emotional and sensory dimension of the tours: “Cheki proposed the word ‘experience’ because the concept dominates today’s hospitality industry. We liked the idea and took it a step further adding the ‘the’ and exclamation point,” Laura remembered. They hired a local marketing company to develop the company’s brand identity: logo, website, and tri-fold and rack brochures (Exhibit 2). “Explore...Engage...Experience,” read their new logo.

E!FL was officially incorporated in January 2007 as an LLC with operations scheduled to start in May 2007 during the graduation weekends of the two local colleges, Cornell University and Ithaca College. The couple operated their company from home picking up guests at pre-established departure points around Ithaca. While Alan took care of the transportation and finance and accounting component of the company, including purchase of a 14-passenger touring van, insurance, and driver requirements, Laura worked on the marketing aspects.

Developing Partnerships

In the intervening four months, the Falks searched the region to find their partners who would participate in the tours. In particular they wanted selected wineries: “We explained to our potential partners that we would bring to their doors customers interested in wine appreciation, and the cultural and natural heritage of this wine region, and more likely to buy wine than the average customer. We described how we wanted to give them an exceptional experience distinct from what other mainstream visitors usually had.” Many of the Finger Lakes wineries offered fine, dry wines, while others had a range of sweeter varietals. Although an increasing number of visitors seek out the finer wines, a substantial number are interested in a fun time that involves drinking, and are unlikely to become regular clients or even remember their winery.

The wineries that sought to develop a clientele for their vintages were receptive to the Falks’ message. Half a dozen of them agreed to provide special treatment to the E!FL guests

Summary of Experience! The Finger Lakes® touring services

Standard Tours

Along Cayuga Lake:

Wine, Cheese, and a Side of "Moo": A Farm to Barrel Experience	2 cheese farms and 3 wineries with cheese samples and wine tasting
Cayuga Wine Trail West "Taste & Learn"	4 west-side wineries; Food-wine pairings; Taughannock Falls; vineyard & winery tour
Chef's Selection: Culinary Wine Tour on Cayuga (seasonal)	4 wineries paired with regional cuisine
Tasting Through Time: History of Drinking in the Finger Lakes	Cayuga Wine Trail with an historical twist; 1 cidery and 3 wineries; Food-wine pairings.
Cayuga Lake Eastside Sampler	2 East-side wineries; Food-wine pairings; Salmon Creek Falls; Food-wine pairings; MacKenzie-Childs farmhouse tour and shopping
"Made in Ithaca" Tasting Tour	1 eatery, 1 creamery, 1 brewery, and 1 winery; Food and drinks sampling.

Along Seneca Lake

The "SWaB" Tour: Spirits, Wine and Beer along Seneca Lake	1 distillery, 2 wineries, and 1 brewery; Drink-food pairings.
Vinifera Varieties: Wines of the Seneca Lake Banana Belt	4 wineries; Food-wine pairings; barrel tasting

Recreational Tours (seasonal)

Cayuga Lake Boat Cruise & Taughannock Falls Trek; Ithaca Is Gorges and Waterfalls Tour; Natural History Hike through Enfield Gorge
--

Miscellaneous tours

Ithaca Living History Tour; Between the Lakes Sustainability Tour; "Historic Auburn" Tour

Custom Tours

Examples:

The Ultimate Bachelorette Weekend; Barrel & Wine Tasting Rehearsal Dinner; Post-Wedding Ceremony Wine Tasting and Celebration Dinner; 3-Brothers Scavenger Hunt Birthday Adventure Tour; Wine tasting and Private Dinner Birthday Celebration at the NY State Wine and Culinary Center
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Packages

Examples:

The ultimate bachelorette package (hotel, wine tour, gift card for restaurant, bar and spa, Hangar Theater show)
Living the suite life for six package (hotel, winery tours, gift card for restaurant and ice cream)
Girls' getaway for four package (hotel, winery tour, gift card for restaurant, spa, and ice cream).
Wine and theater package for two (Hangar Theater show and winery tour).

Reception Services & Conference Excursions

For charter groups and motor coach tours: full planning and itinerary development, step-on guide services to the wineries, gorges and other points of interest in the Finger Lakes.
For conferences and meetings held near Ithaca: full destination management services.

Itineraries

Custom full planning and itinerary development.

Finger Lakes locator map

Sculpted by glaciers, the Finger Lakes region features gravel soils and steep-sided hills that create numerous microclimates ideal for cool-weather grape varieties. In addition to the wine trails on the two largest lakes, Seneca and Cayuga, wine trails are also established on two smaller lakes, Keuka and Canandaigua.



for their standard tasting fee (from \$2 to \$5 per person for a selection of wines, depending on the winery). The E!FL guests would be offered a separate tasting that provided a more detailed discussion of the wine and featured specific food pairings. Selected “featured wineries” would give vineyard and winery tours or private barrel tastings, often conducted by the owner or the manager of the winery. Laura kept track of wine bottle sales generated for the wineries by her guests: “We aimed for the goal of one bottle per person.” The Falks also approached local hotels and restaurants for joint marketing opportunities.

With their narrative ready, they organized their first tour, which was a fam tour. “Our first tour was a familiarization tour: we invited 12 sales managers from hotels in the area to show them what we did and how different we were.” They also contacted Cornell, which agreed to allow them to participate in their alumni reunion weekend, a significant achievement since no other organization outside of Cornell featured direct programming to the alumni at the event.

Taking Off

E!FL proposed three five-and-one-half-hour standard narrated tours, most of them on weekends. One tour visited the area’s gorges and waterfalls, another took in wineries, waterfalls, and shopping experiences on the east side of Cayuga Lake, and the other stopped at four wineries on Cayuga Lake’s west side. All tours featured hilltop views

of the lake, which extends 35 miles. The firm also offered custom tour and itinerary services for guests interested in tailored travel plans (see Exhibit 3). Laura was the driver and the guide on winery tours, and Alan did the gorges and waterfalls tours, which included Taughannock Falls, one of the highest single-drop falls east of the Appalachians and other falls that visitors might never see because they were off the beaten path. E!FL set a minimum tour size of 4 guests per van. Tours were initially priced at \$65 per person, which included tasting fees, snacks and water on board the vehicle, and special tour amenities to make their trip memorable. The only extra expense was the optional gratuity for the guide. “We covered our costs but we made no money the first year,” remarked Laura.

The two college graduation weekends turned out to be a flop: “We had advertised in the Cornell and the Ithaca College newspapers, but we had not realized that during graduation all the activities were centered on the campus, and people did not want to go out touring.” Instead their first business came in July through their web presence and through referrals from the Cayuga Wine Trail (CWT), a marketing association grouping some 16 wineries and cideries along Cayuga Lake, which listed E!FL as an associate member on their website. Small amounts of business also came through the hotels and Ithaca Visitors Bureau. “We realized that our website was really the face of our company and that

E!FL's key growth statistics from winery tours (2007–2010)

	2007	2008	2009	2010
Number of guests	179	336	664	1,003
Group average size	7	7.6	8.3	9.5
Number of tours	26	44	69	91
Number of vans	1	1	1	2*
Price per person for standard tours	\$65	\$75	\$85	\$90

* Note: Second van added April 2010.

it would be our primary marketing tool,” commented Laura. That first year, with business peaking in the fall grape harvest and leaf peeping season, E!FL covered its costs and finished with some money in the bank for the next season.

Adding New Services

In the two subsequent years, the company grew 88 percent and 98 percent (Exhibit 5), and Alan and Laura hired three additional tour guides to supplement the crew in the peak summer and fall seasons. Laura spent the winters on the road visiting wineries, chocolate shops, restaurants, and hotels to recruit new partners, add value to their tours, and gain travel agent knowledge to deliver on their concierge promise. “With more partners on board, we could become more creative in designing standard and custom tours and refer our guests to the best hospitality businesses in the region,” Laura explained. E!FL added two Ithaca restaurants as partners to their tours, the lakefront Boatyard Grill and the downtown Blue Stone Grill, both of which agreed to treat E!FL guests as VIPs. The company also enrolled new wineries on Seneca Lake, allowing it to propose a Seneca Lake winery tour. Value-added experiential touring also drove higher rates, with standard tours now selling at \$85.

In 2009, E!FL also had their first experience in the lucrative business of reception services and conference excursions, as a “destination management company” organizing itineraries and step-on guide services to the wineries, gorges, and other points of interest in the Finger Lakes. That year, Laura and Alan provided such services for a 50-person bus chartered by a Pennsylvania travel agency and later for a 550-person conference (split into eleven tours). “It was a lot of planning, reservations, and hiring of subcontractors, with anxiety building up ahead of time, but this business brought us a sizable income in winter and early spring when E!FL activity is low,” commented Laura.

At the end of 2009, E!FL had gathered momentum and was generating profits. In addition to the CTW’s referrals,

E!FL benefited from referrals from the Seneca Wine Trail and Finger Lakes Tourism Alliance (FLTA), a regional tourism promotion agency representing the 14 counties surrounding the eleven Finger Lakes. The company was by now partnered with 10 Cayuga Lake wineries, 7 Seneca Lake wineries, 1 Keuka Lake winery, 1 cidery, 3 breweries, 1 distillery, 1 chocolate shop, 1 ice cream shop, 2 regional wine centers, 14 restaurants, and 13 regional attractions.

An increasing share of business stemmed from local hotel referrals, in particular from La Tourelle Resort and Spa, an upscale property which featured E!FL in packages on its website. At the same time, Laura and Alan observed that their website’s package tab, although limited to mostly referral links, was the second most clicked tab by visitors. Laura explained:

People were looking but we were not delivering, so after I attended a seminar offered on packaging though FLTA, we took the lead to create our own packages. In order to make them profitable, we initially set them up for groups of minimum 6 people so we could fill half of our van.

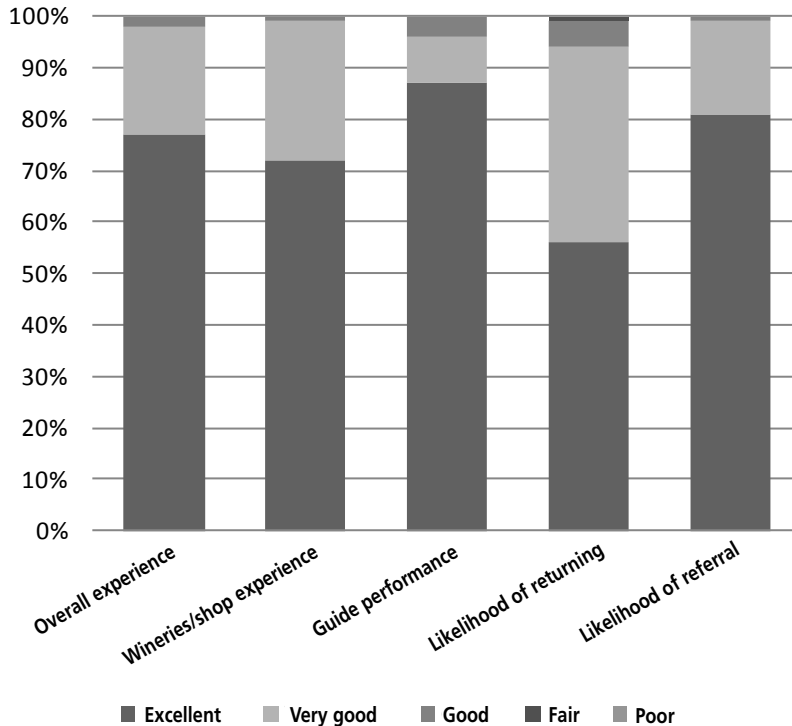
Reaching a Plateau

In 2010, E!FL continued to grow. The core business of winery tours represented 90 percent of the company’s touring business, mostly through standard tours. Packages proved successful, representing a 30-percent share of business. Guest ratings from evaluation surveys handed in at the end of each tour were more than encouraging (Exhibit 5): 88 percent were ready to tour again with E!FL. Evaluation surveys also revealed that 50 percent of the guests had found E!FL through Google and the internet, 27 percent through word of mouth, 22 percent through hotel referrals, and 1 percent through Facebook. In 2010, 10 percent of E!FL’s patrons were returning customers from previous years.

Yet, although the business grew a healthy 51 percent, the Fawks felt their incremental growth approach was not

EXHIBIT 6

Ratings for E!FL's tour arrangements



creating a fast enough rate of return. In April, the Falks had doubled their capacity by adding a second 14-passenger van, but 2010 had generated barely enough tours to recoup its cost.³ Heading into 2011, their fifth year of business, Laura and Alan concluded that they needed to ramp things up. As they were brainstorming about how to proceed, a friend recommended they look at promoting through Groupon, which had launched operations in the Syracuse market in October 2010.⁴ They decided to give it a shot with Laura as the “face to the deal,” and Alan doing the due diligence.

An Overview of Groupon

Groupon’s website features discounted gift certificates for local and national companies, and it also sends offers to a list of subscribers, thereby harnessing the collective buying power of its large user base to offer huge discounts on local services and products. While Groupon mostly worked with

³ The second van had to be used at least once a month to cover lease and insurance costs.

⁴ Syracuse joined New York City, Rochester, Buffalo, Long Island, Albany and Westchester County as markets in New York. During its first weeks in Syracuse, Groupon’s featured deals included vegan cuisine, pilates classes, hair salons and a cupcake bakery. “Groupon Launches in Syracuse,” *Enhanced Online News*, November 08, 2010. <<http://eon.businesswire.com/portal/site/eon/>>, viewed on 06/05/2011.

small retailers, it had also become famous for national deals, such a Gap Groupon that went viral in August 2010 and resulted in 445,000 coupons sold in one day, for \$11 million.⁵

History

Groupon grew out of The Point, Inc.,⁶ a website platform for organizing all forms of collective social action, launched in November 2007 by Andrew Mason, current CEO of Groupon. The first market for Groupon was Chicago, where the company’s headquarters was located, followed soon thereafter by Boston, New York City, and Toronto. In 2009, Groupon had about 120 employees and was present in 30 cities. As of March 2011, Groupon employed some 1,400 persons in the U.S. and 4,000 overseas. The company had account executives in more than 500 markets and regional offices spanning over 44 countries in Europe, Latin America, and Asia.⁷ The number of Groupon subscribers had grown from 1.8 million in 2009 to 50 million in early 2011.⁸

Referred to in the press as a “The fastest growing company ever,”⁹ Groupon had enjoyed exponential growth. In 2010,

its revenues reached \$760 million from \$33 million the previous year.¹⁰ In April 2010, Groupon raised \$135 million from Digital Sky Technologies. In December, the company spurned a \$6 billion takeover bid from Google and went on to raise \$950 million in financing from private investors.¹¹ In early 2011, Groupon was rumored to be preparing for an initial public offering.¹²

⁵ The \$25 coupon was for \$50 worth of merchandise. Wailin Wong, “Gap’s Groupon Pulls in \$11 Million,” *Chicago Tribune*, August 20, 2010.

⁶ The Point was privately owned and backed by private investors, New Enterprise Associates (a venture capital firm that helped grow Career-BUILDER, Vonage, and UUNET), Accel Partners (a venture capital firm that invested in Facebook, Etsy, comScore and StumbleUpon), and Digital Sky Technologies (an internet investment firm that invested in Facebook and Zynga).

⁷ <http://www.groupon.com/about>, viewed on 06/05/2011.

⁸ Jennifer Saba and Clare Baldwin, “Groupon Worth \$25 Billion? Nope,” *Reuters*, March 15, 2011.

⁹ Steiner, *op.cit.*

¹⁰ Michael Hickins, “Groupon Revenue Hit \$760 Million, CEO Memo Shows,” *The Wall Street Journal*, February 26, 2011.

¹¹ Amir Efrati and Geoffrey A. Fowler, “Google Plots Move From Search to Sales,” *The Wall Street Journal*, December 1, 2010.

¹² Saba and Baldwin, *loc.cit.*

“By this time next year, we will either be on our way to becoming one of the great technology brands that define our generation, or a cool idea by people who were out-executed and out-innovated by others that were smarter and harder working,” conceded Mason in an internal memo to employees in early 2011.¹³ His goals for the company in 2011 were to increase the share of “national deals,”¹⁴ to reach 150 million subscribers, and to generate at least \$1 billion in revenue from new products launched in 2011 (as opposed to the company’s current daily email blast).

Business Model

The company offered one Groupon deal per day to subscribers in each of the markets it served. Groupon made the deals visible by buying ad space through Facebook, Twitter, and Google. The deals were activated only when a minimum number of people agree to buy (“tip” in Groupon parlance), encouraging subscribers to share the promotion with family and friends. Once the deal tipped, the merchant and Groupon split the revenue roughly 50/50, and a group of customers had an unbeatable bargain. Groupon paid special attention to customer care. If a customer felt that Groupon had let them down, they could return a Groupon, no questions asked—even if they had used it. The company maintained a 24-hour-a-day hotline so that any customer could call at any time.¹⁵

The demographics of the Groupon subscriber were attractive to many businesses. The typical Grouponer was young (68% were aged 18 to 34), educated (50% had a Bachelor’s degree and 30%, a graduate degree), working (75% worked full time), single women (77% were women and 49% were single), and had disposable income to spend (48% earned over \$70,000).¹⁶ Grouponers were habitual users of social media in general, nearly all had Facebook accounts, and many also used Twitter, blogs, YouTube, and other social websites. Owing to its demographics, Groupon deals were often focused on the health, fitness, and beauty markets.

To communicate to this audience, Groupon promoted its deals with a puckish, original writing style. As a consequence, according to Groupon surveys, 66 percent of its subscribers read the Groupon write-ups every day. Although the deals were primary, readers kept coming back to be entertained by the storytelling. The company employed 70 comedy writers, many plucked from Chicago’s improvisa-

tional comedy scene, to churn out the witty and whimsical pitches that accompanied the deals.¹⁷

Groupon coupons appealed to merchants by guaranteeing retailers a minimum number of walk-in customers, no upfront cost to participate, and widespread exposure. But the company was selective in the deals it featured. Groupon declined seven of every eight possible deals suggested by merchants.¹⁸ To be considered for the deal of the day, vendors first needed outstanding reviews. Then their deals had to offer a substantial discount from normal prices and be different from other promotions regularly offered by the vendor. According to Groupon business surveys posted on its website, 97 percent of firms using Groupon wanted to be featured again because Groupon had brought in quality customers (92% of respondents), who spent an average of 60 percent above the value of the Groupon, and who were likely to be repeat customers (89% of respondents).

Competitors

While not directly in the online coupon space, “social couponing” companies such as Groupon, had benefited from the couponing comeback of the mid 2000s, which was fueled by recession, rising food prices, and the advent of digital marketing and social media. Although online coupons accounted for only 1 percent of all coupons distributed, they accounted for about 10 percent of all coupons redeemed.¹⁹ In 2010, the number of coupons available at major online distribution sites increased by 33.6 percent from 2009 and the number of manufacturers offering them (290) grew by 17 percent.²⁰

Though Groupon held a 60-percent market share in the social couponing segment as of February 2010,²¹ it was not without competitors. Group-buying websites were relatively easy and inexpensive to create and maintain. With minimal

¹⁷ As an example, copy for microdermabrasion treatment at a spa: “Removing the top layer of skin from a face is good for more than just solving every single Scooby-Doo mystery; it can also result in a smoother, healthier face; <http://www.groupon.com/deals/spa-space>.

¹⁸ Weiss, *op.cit.*

¹⁹ According to the “2010 Coupon Facts Report” from NCH Marketing Services, Consumer Packaged Goods (CPG) manufacturers offered consumers \$485 billion in coupon savings in 2010. This represented a 13.9% increase over 2009 and 47.4% growth compared to 2005. Freestanding Inserts (FSI) in newspapers accounted for 87.7% of U.S. CPG coupon distribution and digital coupons less than 2%. Redemption volume for CPG coupons grew 3.1% to \$3.3 billion. Digital coupon redemption share was 9.8% of total coupon redemption in 2009, up from just 1.1% in 2006. In that same time period, the print FSI redemption share—out of the total number of coupons redeemed—dropped from 63% to 50%.

²⁰ According to Marx, Minneapolis; <http://kantarmediana.com/marx/press/kantar-media-reports-digital-coupon-events-increased-336-percent-2010?destination=read-about-us>; viewed on 06/11/2011.

²¹ According to neXtup Research in: “Groupon Anxiety,” *The Economist*, March 19, 2011.

¹³ Hickins, *op.cit.*

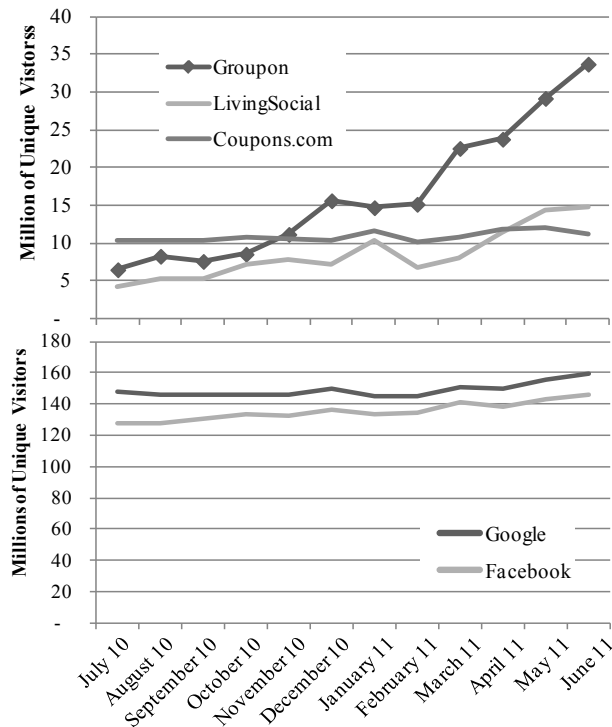
¹⁴ National deals accounted for 12 percent of revenue in the fourth quarter of 2010.

¹⁵ Bari Weiss, “Groupon’s \$6 Billion Gambler,” *The Wall Street Journal*, December 18, 2010.

¹⁶ <http://www.grouponworks.com/why-groupon/comparison-guide>, viewed on 06/05/2011.

EXHIBIT 7

Comparison of visitor volume on social media sites



barriers to entry, Groupon was dependent on its brand and first-mover advantage to maintain market share. Mason estimated that there were some 500 copycats worldwide,²² including 100 in the United States.²³ Only one competitor, LivingSocial (Exhibit 7), which had just received a \$175 million investment from Amazon, was considered as a serious competitor.²⁴ LivingSocial, launched in July 2009, started out developing applications used on Facebook, then pivoted into daily deals after seeing Groupon’s success. As of early 2011, it had 16 million subscribers with revenues in 2010 estimated at \$200 million.²⁵ Together Groupon and LivingSocial accounted for 92 percent of the web traffic in the social couponing sector. The third-best-trafficked site, Mamapedia Sweet Deals, represented 1.4 percent.²⁶

Groupon also faced looming competition from Google and Facebook. In early 2011, reports surfaced that Google

²² Weiss, *op.cit.*

²³ Other notable firms operating in the “group buying” sector market included BuyWithMe, (26 markets), TownHog (44 U.S. markets), Eversave, KGBDeals, and Mamapedia Sweet Deals.

²⁴ Bill Saporito, “The Groupon Clipper,” *Time*, February 21, 2011.

²⁵ Annie Lowrey, “Are Group Buying and Coupon Deal Companies Like Groupon and LivingSocial in for a Bubble?,” *The Washington Post*, January 16, 2011.

²⁶ According to December site-visit data compiled by Experian Hitwise, a research and analysis firm, cited in Lowrey, *op.cit.*

was planning to launch a competing product, called Google Offers, and Facebook began testing a social-buying program.²⁷ Indirect competition also came from the more traditional digital coupon companies such as coupons.com, the largest provider of digital coupons (and the 43rd largest website in the U.S.), which was valued at \$1 billion,²⁸ and which received a \$200 million private investment in 2011.²⁹

To maintain its dominant position, Groupon increased its deal frequency to more than one per day in most markets and took on more small business clients. It also started “Groupon Stores” in some markets to allow merchants to create their own deals. Since Groupon employees were not directly involved in those promotions, the firm accepted a cut as low as 10 percent. The company was also investing in better data mining to personalize the deals by using variables like gender, neighborhood, and buying history to decide which deal came up on a particular subscriber’s screen.

Finally, Groupon was extending its business into additional market segments, such as travel. In June 2011, Mason announced “Groupon Getaways,” a partnership with Expedia. The new venture was to offer deep discounts on travel-related services by tapping Expedia’s access to 135,000 hotels, as well as car rental and cruise options.³⁰ Expedia had already partnered with Groupon to provide daily deals in the U.K. According to a senior director of new channel sales at Expedia, Groupon Getaways was an opportunity worth considering for travel suppliers, as “a low cost, low risk customer acquisition and brand introduction channel.”³¹ She underlined the cross-selling opportunities (Groupon customers have been shown to spend as much as 60 to 80 percent on top of the value of the Groupon), and the opportunity to attract off-season business and sell rooms that would otherwise remain vacant. She claimed that travel suppliers would:

“Win new guests and awareness [...], reach millions of people in one day with a direct offer [...], no comparison shopping, no website cruising [...], be on the leading edge of the e-marketing revolution and enjoy the buzz and exposure that comes with it, [...] spend marketing dollars on real customers

²⁷ Saporito, *op.cit.*

²⁸ Evelyn M. Rusli, “With Eye on Public Offering, Coupons.com Attracts Big Investments,” *The New York Times*, June 9, 2011.

²⁹ Founded in 1998, Coupons.com was a survivor of the dotcom boom and bust, which allowed users to download and print coupons from traditional purveyors of coupons like Clorox, General Mills, KMart, and Walgreens. Its network spanned thousands of sites, including retailers, publishers, consumer electronics, shopping cards, and apps.

³⁰ Geoffrey A. Fowler, “Groupon Launches Deal Site With Expedia,” *The Wall Street Journal*, June 1, 2011.

³¹ “Expedia: What Groupon Getaways with Expedia Means for Hotels,” Special Nodes; www.tnooz.com/2011/06/22/news/expedia-what-groupon-getaways-with-expedia-means-for-hotels/, viewed on 06/22/2011.

rather than on other efforts that are hard to measure, and may or may not work.³²

Working With Groupon

Crafting a Groupon Tour: Easier Said Than Done

Laura visited the Groupon website to learn more about the company and was comforted that their service was promising for E!FL's business:

Groupon guaranteed walk-in customers from the Syracuse area, and we knew from our evaluation surveys that if we could get people in the door, they would probably come back and tour with us, especially if they came from close by. Also, their demographics made a good match for us; the majority of the 55,000 registered Groupon users in the Syracuse market were primarily young, educated, female customers (Exhibit 8).

The Groupon ad would be optimal if the Groupon guests would occupy empty seats during the slow early spring season. For this to happen, the Falks had to move fast and have a coupon ad featured on Groupon by the end of March. In mid-January 2011, Laura submitted a request through the Groupon website. "The first contact was incredibly easy: I went on their website, watched a tutorial video, and filled in a three-question application form with the name of our company and a five-line description of its activity," Laura recalled.

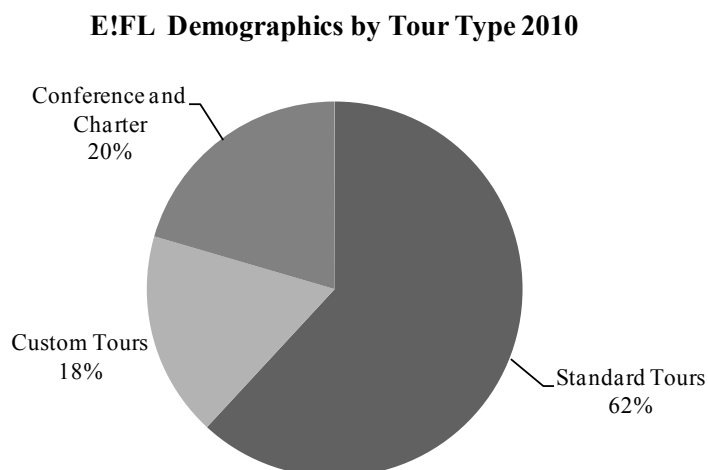
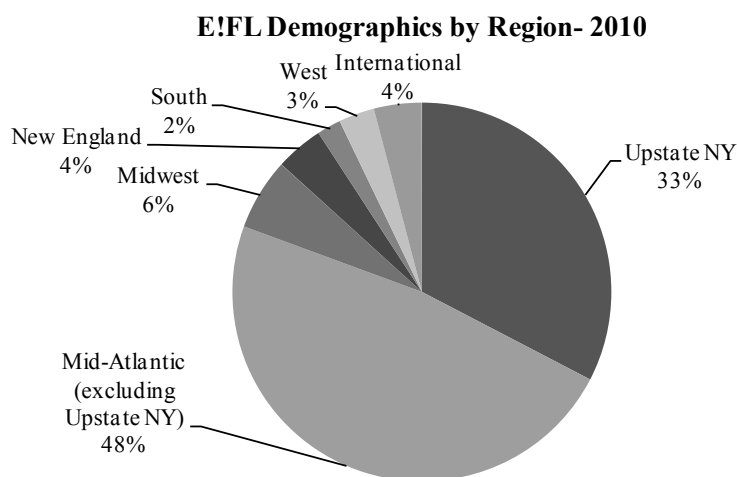
Three weeks later, a Groupon representative covering the Syracuse area called the Falks to tell them that he was interested in running a Groupon coupon with E!FL. The conversation quickly turned into a brainstorming session on the type of tour E!FL could put together. "We need to find a deal that is appealing to Grouponers and sustainable for your business, if the promotion fails we both lose," he pointed out. Laura proposed a hotel package option, because she felt confident she could share the Groupon marketing cost with them, but the rep preferred to focus on the company's day tours, on the grounds that people coming from Syracuse would not want to stay in Ithaca, which was only about an hour away. Laura then proposed E!FL's two most popular tours as candidates for Groupon: the Cayuga Wine Trail West Taste & Learn and the Vinifera Varieties: Wines of the Seneca Lake Banana Belt.³³

³² *Ibid.*

³³ The region around Seneca Lake had become known as the "Banana Belt" due to its extraordinary microclimate that was ideal for growing the European vinifera grapes.

EXHIBIT 8

E!FL demographics



Laura announced that her goal was to attract at least 100 new customers through a Groupon ad. Based on previous Groupon wine tasting promotions in the Syracuse area, the rep estimated that E!FL would get a minimum of 75 buyers. In November 2010, a Groupon promotion sold 261 coupons for a \$5 wine tasting & bottle of wine, a \$15 value at Syracuse's Lakeland Winery, which is in the business of providing varietal juices to would-be winemakers. Another Groupon, in January 2011, offered a wine tasting and pairing for two, plus a wine card from the Finger Lakes Wine trail wineries. Valued at \$70, this \$30 offer generated 51 purchases. "The fewer restrictions you put on the Groupon, the better it will sell," the rep insisted, alluding to limits on duration of promotion and redemption of coupons, upper limits on the number of coupons to be sold, or limits on number of coupons per person. The discussion then moved to pricing:

According to [the rep], we had to propose at least a 50-percent discount [that is, a tour at \$45 per person] to make the coupon attractive. I pointed out that since Groupon would take half, I would in fact sell my tour at a 75-percent discount, which would result in our losing money with each sale.

Next, the rep offered advice on how E!FL could mitigate costs, while preserving the attractiveness of the ad:

His recommendation was to keep the 50-percent discount but to raise the value of the tour to \$110 [a \$55 coupon], for example by adding a free \$20 bottle of wine or some \$20 worth of coupons on wine purchases. This meant that the wineries would have to agree to share with E!FL the cost of the Groupon ad campaign, and it was likely that only a few would buy in.

Laura asked the rep for a couple of days to contact the wineries and see whether the deal was feasible. First, she called one of E!FL's largest winery partners to test the Groupon idea. The winery was receptive to the proposal, but advised against the free bottle of wine, pointing out that it would put wineries in a delicate situation vis-à-vis their distributors. Meanwhile, Laura examined her costs to estimate which was the maximum cost she could afford per Groupon guest versus regular paying guest for E!FL to break even. That is, she needed to calculate what was a sustainable cost for a tour of, for instance, six guests, if all of them used a Groupon. She reached the following conclusion:

Increased value was a good idea, but it was clear that we also needed to decrease our costs, such as the wine tasting fees, which represented the largest chunk of our costs. If they could be waived, we would cover our cost for each Groupon guest with the minimum of six guests per tour. But I needed a fast answer from the wineries so the Groupon ad could be posted on the web by the end of March.

Laura then sent an email to all her winery partners inviting them to join the Groupon deal, underlining its benefits in terms of exposure for their brand (55,000 viewers for one day and an estimate of 75 to 100 walk-in customers), and asked them to share some of the cost by waiving tasting fees and to increase value by offering some discount on an item purchase. Within two days, four Seneca Lake wineries agreed to waive their fees and offer a \$5 discount on wine purchase. Laura proposed the following E!FL tour coupon to Groupon: a \$55 guided wine tour of the Seneca Lake Banana Belt that included visits to four wineries with a free tasting at each and a \$5 discount on a wine purchase (up to \$110 value). The following day, Groupon accepted that proposal and emailed the Falks a contract.

Negotiating the Contract

Although the two parties had worked out the deal's outlines, they needed to settle the details. In addition to the proposed

tour coupon, the rough draft of the Groupon contract contained the company's merchant account terms and conditions (which are posted on its website). Looking at these details, Alan determined that many contractual aspects still needed to be negotiated. "I was not as enthusiastic as Laura because in my opinion the contract protected more the interests of Groupon than ours; Groupon's interest was to sell as many coupons as possible, ours was to gain a manageable number of discount guests who would spread the buzz and bring in additional business."

As a marketing company, Groupon's responsibility ended when the customers bought the coupons online. It was not liable for operational problems such as the number of coupons sold, the time when coupon holders would choose to redeem their coupons, or whether coupon buyers would be one-time-only visitors, existing customers, or purchasers of multiple coupons. Alan noted both the reports of small businesses that enjoyed huge sales days and an influx of new customers thanks to Groupon, and cautionary tales about disappointed small businesses that ended up losing money because they saw too few customers, too many customers, or the wrong kind of customers. An independent academic research study found significantly lower satisfaction levels from Groupon businesses than the ones advertised by Groupon on its website.³⁴ Out of 150 Groupon businesses interviewed for the study, 32 percent said they did not make any money from them, and 42 percent said that they would not do another daily deal. Disappointed retailers cited a low rate of repeat Groupon customers buying at full price and a low rate of Groupon customer spending beyond the coupon value. The study also referred to previous research showing that price discounts eroded brand value in the long term.

Consequently, the Falks set up a list of the contractual terms they wanted to discuss:

Customers buying multiple coupons. To gain the maximum number of new visitors, the Falks wanted to limit coupon sales to one per person (non transferable), with two additional ones as gifts.

Length of redemption period. The Falks had no way of controlling exactly when the Groupon guests would redeem their coupon. They also had limited control regarding when their ad would go online, since Groupon as a policy would not commit to a specific date to feature the ad.³⁵ The Falks wanted the ad to specify that an online reservation

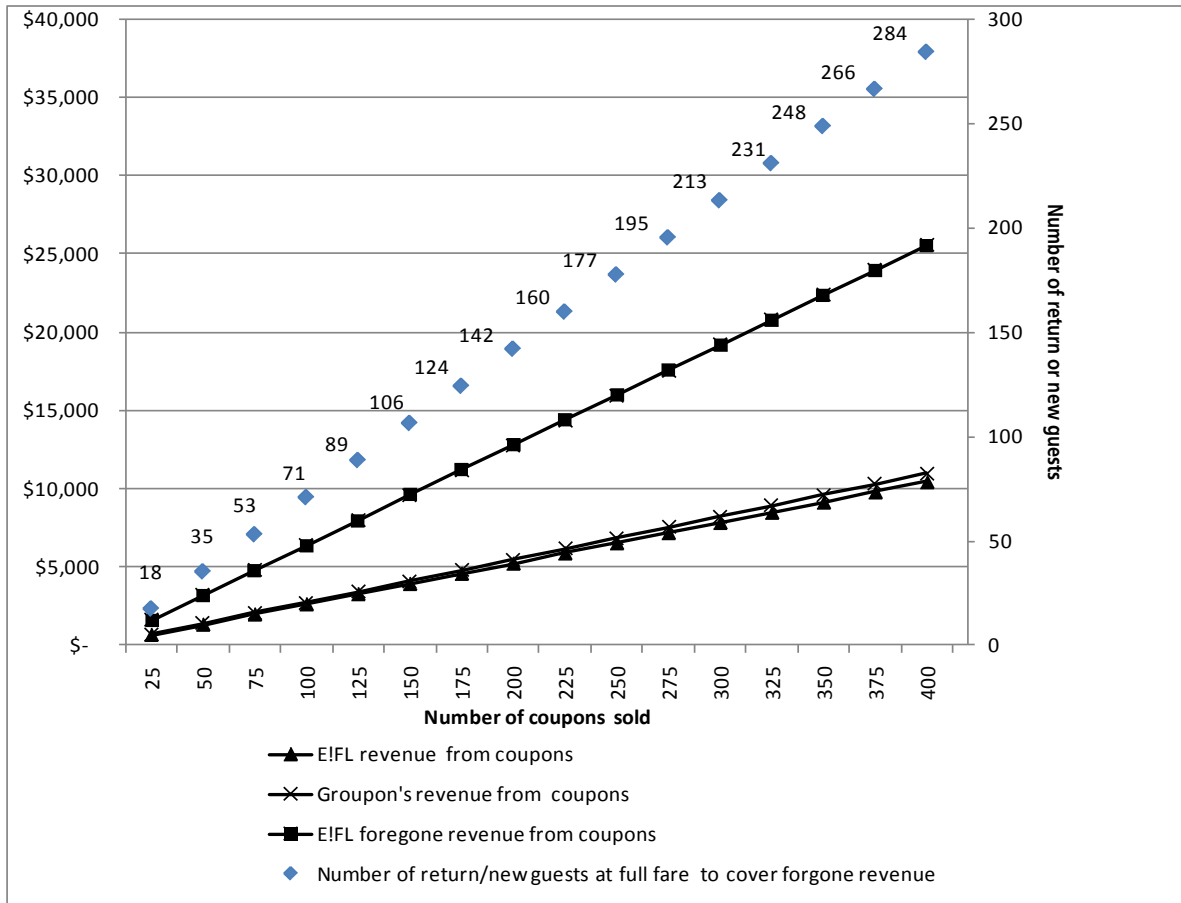
³⁴ Utpal M. Dholakia, "How Effective are Groupon Promotions for Businesses?," Rice University news release, Jesse H. Jones Graduate School of Management, September 28, 2010.

³⁵ "Groupon reserves the right to feature anything in our pipeline at any time, just in case there are time-sensitive deals that come to our attention at the last minute. We use metrics and past trends to determine the best placement for each feature. To make sure you have time to prepare your business and that all questions have been answered, we always contact you before we feature your business"; www.grouponworks.com/faqs, viewed 06/01/2011.

EXHIBIT 9

Estimated revenue and cost from the sale of Groupon coupons

Groupon coupon price	\$55.00
Groupon's revenue on each coupon sold	- \$27.50
Credit card transaction fee paid by E!FL (2.5%) for each coupon	- \$ 1.38
E!FL Total revenue for each Groupon coupon sold	\$26.12
E!FL revenue loss for each Groupon guest if taking away seats from full paying customers (\$90 - \$26.12)	\$63.88



was required for the coupon and that space was subject to availability. Requiring reservations had two functions. In addition to the obvious one of setting up tours, this would also give them access to the names and emails of the prospective Groupon guests. Since they ran a seasonal business, the Falks did not want to extend the offer into the next season. They knew the coupon would have to have an expiration date, but were not sure what redemption deadline made the most sense for their business.

Coupon cap. Alan was also concerned about the possibility of being overwhelmed by Groupon customers, as well as lost revenue. “No upfront cost did not mean the Groupon was free, even if we covered our costs with the Seneca tour. I

felt that we needed to structure our deal further by restricting the number of coupons sold, as E!FL and our partners could not handle an onslaught of Groupon guests,” he concluded. For every Groupon guest, E!FL would not lose money but would have to forgo \$63.88 in revenue (Exhibit 9).³⁶ At 400 coupons sold, for instance, the forgone revenue would be \$25,552, or the equivalent of 284 repeat or new guests paying full fare. But Laura was reluctant to cap the

³⁶ As a comparison, if E!FL created the same 50-percent-off sale and promoted it via Facebook Ads instead, for \$63.88 forgone revenue per guest, at \$0.50 per click, the ad would generate $63.88/0.5=127.76$ chances to make a sale. That would be a conversion rate from click to sale of $(1/127.76 \times 100) = 0.78\%$. Hence to outperform Groupon, a minimum conversion rate goal of 0.78 percent would need to be achieved.

deal for fear of making the coupon unattractive to Groupon: “We are a little fish; they do not need us.”

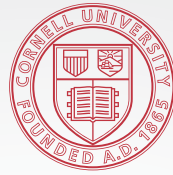
Credit card processing fee. Most contracts with Groupon passed the 2.5-percent credit card transaction fees on to the merchant. Groupon collected customer payments, distributed Groupon vouchers to those customers, and mailed merchants a check for net proceeds. Since E!FL would receive only half of the coupon’s value, Alan wanted Groupon to at least cut the credit card fee in half, if not waiving it entirely.

The Groupon “editorial” or ad. To maintain its web persona, Groupon required merchants to relinquish their right to write or co-edit their ad, except for specific facts. Groupon took care of the copy to ensure that every Groupon ad was “engaging, entertaining, and non-intrusive” and resonated with their subscribers. The Falks were worried that Groupon, to entertain its subscribers, would downplay the educational and cultural aspects the E!FL tour and focus instead on drinking, thereby attracting the wrong kind of guests. While numerous wineries cater to guests who seek entertainment, the four wineries on this tour directed their

attention to educating guests about their wines and production methods. Besides, to honor their engagement, the Falks had to have the name of the four Seneca wineries of the tour high up on the advertisement.

Should They Take the Leap of Faith?

This last issue embodied the Falks’ biggest concern. There was no way to negotiate a contract that ensured that they would not attract the wrong kind of guests: the ones who were only interested in overdrinking and who would spoil the experience for the other guests. They were also concerned about the one-time bargain hunters who would not use the \$5 voucher to buy a bottle of wine and who would not tip the guides; or the existing E!FL customer who after purchasing the Groupon deal would not buy the tour at full fare again. Worst of all would be the possibility of a guest who came with unrealistic expectations: “One bad review on Trip Advisor can go a long way,” remarked Alan. As Groupon explained on its website: “Our subscribers are not looking for ‘the perfect deal,’ they’re looking for the perfect excuse to try something new; we get them to your business, and you bring them back again and again.” ■



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