GROUPON, INC.

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EXECUTIVE SUMMARY

Groupon, founded in 2008 by CEO Andrew Mason, is the market leader in the daily deal industry. The company has shown impressive growth since 2009, now with approximately 150 million subscribers worldwide and 1.6 billion dollars of revenue in 2011.[i] But the industry itself is still very new, with investors waiting for Groupon to demonstrate bottom line profitability.

In the following report, Griffin Consulting Group has identified industry wide issues as well as issues pertaining specifically to Groupon. Industry wide issues include extremely minimal barriers to entry, intense competition, and a lack of differentiation among competitors' services, while Groupon's issues center around profitability and historically, a reliance on subscriber acquisition for growth. Currently, not even the most informed experts can be certain of the significance of emerging trends in the daily deal industry, so we have put together an adaptable, forward looking strategy that emphasizes aggressive innovation and continued research into best practices.

Our first recommendation is that Groupon begins plans to maximize profitability in the face of slowing subscriber growth. Much of Groupon's growth has been reliant upon quickly expanding the company's user-base. While this has been a successful strategy in gaining market share and increasing revenue, it cannot be sustained at the same rate of growth and will not be a contributing factor in profitability. We have outlined specific steps we recommend Groupon puts into action in the final section of this report.

Secondly, we recommend that Groupon actively differentiate. The daily deal industry has shown rapidly increasing competition, and of the industry leaders, no single company has offered a significantly better service than the other. We suggest an aggressive strategy of continually rolling out multiple improvements to Groupon's service – three main areas of focus will be the transition to a mobile platform, a Groupon rewards program, and increasingly targeted marketing. Groupon must separate itself from the competition, and in order to do this the company must utilize its resources effectively.

Lastly, we recommend continued improvement of the merchant experience. High quality merchant offerings at competitive prices are what drive demand for daily deals. In order for Groupon to continue providing a quality product, merchants must have an incentive to participate in the company's daily deals.

History

Groupon is a website featuring daily coupon deals, with the goal of providing merchants better access to consumers, and visa versa. These deals are generally targeted by the location and personal preference of the user, giving consumers access to coupons and suggesting new goods and services they may be interested in. Discounts often hover around 40-60% off of retail price. Deals may be for food and drink, health and beauty products, services, events, and retail. Groupon operates both by emailing subscribers and by offering deals on their website and mobile application.

CEO Andrew Mason launched Groupon in November 2008. It grew out of the campaign organization website ThePoint.com, which Mason also founded. A former employer, Erik Lefkofsky, provided the initial $1 million investment to get Groupon off the ground. The first deal they offered was for 50% off at a pizza restaurant in Chicago, its initial market, and where it is currently headquartered. The company soon expanded into Boston, New York, and Toronto, and by the end of 2011, had a presence in 175 North American markets and 47 countries worldwide.[ii]

As part of their effort to internationalize, they have acquired a number of similar foreign deal-of-the-day websites. Notably, in the last two years Groupon has acquired MyCityDeal of Europe, ClanDescuento of South America, and SoSasta.com of India, as well as similar companies in Russia, Japan, Malaysia, and Hong Kong. In 2011, the international segment constituted 60.6% of Groupon's revenue, as compared to 36.0% in 2010. Groupon bought Mertado, a social shopping service with the intent to expand its Groupon Goods division. In early 2012, Groupon acquired Hyperpublic and Kima Labs – Hyperpublic builds technology that allows information to be incorporated into location information, and Kima Labs is the creator of the barcode reading app Barcode Hero and the mobile payment app TapBuy. Presumably, these acquisitions will assist in the continued development of Groupon Now, a mobile platform allowing nearby Groupons to be purchased based on the user's location and redeemed instantly.[iii]

Groupon has grown at an incredible rate since its inception. In 2009, they had 37 employees and around $14 million in annual revenue. By the end of 2011, Groupon had grown to over 11,000 employees producing revenues of $1.6 billion. They continue to focus on growing both their consumer base (now around 150 million subscribers) and the number of products they offer (over 190 categories of goods and services).

Groupon executed its IPO on November 4, 2011. Thirty five million shares were sold and Groupon raised $700 million in its initial public offering. There was some controversy surrounding the IPO, as Groupon was accused of masking reported losses through faulty accounting methods. They were forced to revise their IPO filing, and change their operating income of $60 million to an operating loss of $420 million for 2010.[iv] Stocks were initially priced at $20 per share, higher than originally speculated ($16-18). While share prices quickly increased to just over $30, after a disappointing Q4 2011 financial report, they have fallen significantly below the original IPO price.

Financial Analysis

Overview

Groupon's financial success is dependent upon revenue earned from sales of daily deal "Groupons." According to Groupon's annual report, revenue is defined as "…the net amount we retain from the sale of Groupons after paying an agreed upon percentage of the purchase price to the featured merchant, excluding any applicable taxes and net of estimated refunds."[v] An increase in the number of Groupons purchased by customers will show a direct benefit to topline performance. While Groupon has grown extremely rapidly since it was founded in 2008, the number of competitors has also grown very quickly – according to Yipit, there were 383 players in the daily deal industry as of November of 2011.[vi] The majority of competitors are smaller, regional daily deal services, but Living Social, Amazon Local, and other large daily deal competitors pose a significant threat to Groupon's market share over the mid to long run.

Because of Groupon's relatively short history, a financial analysis poses some unique challenges. Directly comparing revenue changes from 2010 to 2011 will tell us little about the true financial health of the company. Additionally, as Groupon only recently announced its IPO in November of 2011, the amount of historical financial data available is somewhat minimal. More importantly, there exists little financial data on competitors – Groupon is the only publicly traded company in the daily deal industry. Using the financial data that is available, we will attempt to analyze trends that may signify potential financial issues moving forward.

We have identified three major performance drivers that have contributed to Groupon's financial success.

PERFORMANCE DRIVERS

1. *Subscriber acquisition* – establishing a large initial subscriber base through the acquisition of new customers, especially on an international level, has been of utmost important to Groupon's growth. Decreasing the marketing costs associated with subscriber acquisition, as a percentage of revenue, will be essential to Groupon's ability to become profitable.

2. *Customer activity and loyalty* – Groupon faces an extremely competitive landscape and consumers suffer minimal switching costs. Therefore, the company must offer services more attractive than competitors to retain subscribers. In addition, reports show that only around 20% of current subscribers actually purchase Groupons[vii], so encouraging activity should be a primary goal. Targeted marketing and a Groupon Rewards program are examples of strategies to address these challenges.

3. *Merchant Incentives* – there are still questions surrounding the benefit seen by merchants participating in daily deal programs. Although a daily deal gets customers in the door, it is often at the expense of a loss on all products sold through the daily deal with no guarantee that these customers will return to pay

full price. In order to continue attracting high quality daily deal offerings, Groupon must demonstrate that a daily deal is a worthwhile investment for merchants.

REVENUE & PROFIT

	(thousands)	2009	2010	2011
Revenue		$14,540	$312,941	$1,610,430
Costs and Expenses				
	Cost of Revenue	4,716	42,896	258,879
	Marketing	5,053	290,569	768,472
	(as % of revenue)	34.75%	92.85%	47.72%
	Selling, general, and administrative	5,848	196,637	821,002
	Acquisition related	0	203,183	(4,537)
	Total Operating Expenses	15,617	733,286	1,843,816
Loss from Operations		(1,077)	(420,345)	(233,386)
Net Loss		(1,341)	(413,386)	(297,762)

Source: Groupon 10-K Annual Report 2011

Since Groupon was founded 3 years ago, it has seen tremendous growth in total revenue. As recorded in Groupon's 10-K report, annual revenue increased from over $312M in 2010 to $1.6B in 2011, a 414.6% increase. This dramatic increase can be attributed to rapid expansion into U.S. and international markets primarily through the acquisition of established daily deal sites. In 2010, over one third of revenue came from international markets, but in 2011 international markets contributed nearly two thirds of revenue. As a result of this tremendous growth in revenue, Groupon has consistently shown a negative operating income – a $420M loss in 2010 and a $233M loss in 2011.

The operating income loss can be largely blamed on drastically increased marketing costs. In order to grow revenue, Groupon has pursued an aggressive subscriber acquisition strategy. The acquisition of new subscribers is reliant upon marketing costs, which have more than doubled from 2010 to 2011. Subscriber acquisition costs include sponsored search, social, portal ads, email, and affiliate programs. These costs are variable according to Groupon's target subscriber growth, the amount of competition (it costs more to acquire a subscriber when many other daily deal sites are also marketing to potential subscribers), and the proportional distribution of marketing channels Groupon decides to use.

While Groupon has managed to acquire roughly 150 million subscribers as of the end of 2011, the number of "active subscribers" totals just 33.7 million (about 22.5% of total subscribers). According to Groupon's 10-K, active subscribers are defined as "…unique individuals that have purchased Groupons during the trailing twelve months."[viii] Because the definition of an active subscriber requires a purchase to be made only in the past 12 months, a very long window of time, we must take the demonstrated decrease in operating loss with a grain of salt. The rapid growth in subscribers has contributed to a decreased operating loss from 2010 to 2011, but it is difficult to say if Groupon's operating loss will continue to shrink. It may be the case that newly acquired subscribers tend to purchase one or two Groupons and then purchasing activity subsides. If this is the case, encouraging continued customer activity would be essential to achieving profitability in the long run.

Cash Flow

(thousands)	2009	2010	2011
Net cash provided by operating activities	$7,510	$86,885	$290,447
Purchases of property and equipment	(290)	(14,681)	(43,811)
Free cash flow	7,220	72,204	246,636

Source: Groupon 10-K Annual Report 2011

Despite negative operating and net income, Groupon has shown a positive free cash flow since the beginning. This situation occurs because of the unique daily deal business model. As defined above, revenue is the net amount paid to Groupon after an agreed upon percentage is given to the featured merchant. But when a consumer purchases a daily deal, the full price is paid to Groupon and the "agreed upon percentage" is not paid out until the customer officially redeems that coupon. As stated in Groupon's annual report:

> "Free cash flow has limitations due to the fact that it does not represent the residual cash flow available for discretionary expenditures. For example, free cash flow does not include the cash payments for business acquisitions. In addition, free cash flow reflects the impact of the timing difference between when we are paid by customers and when we pay merchant partners."[ix]

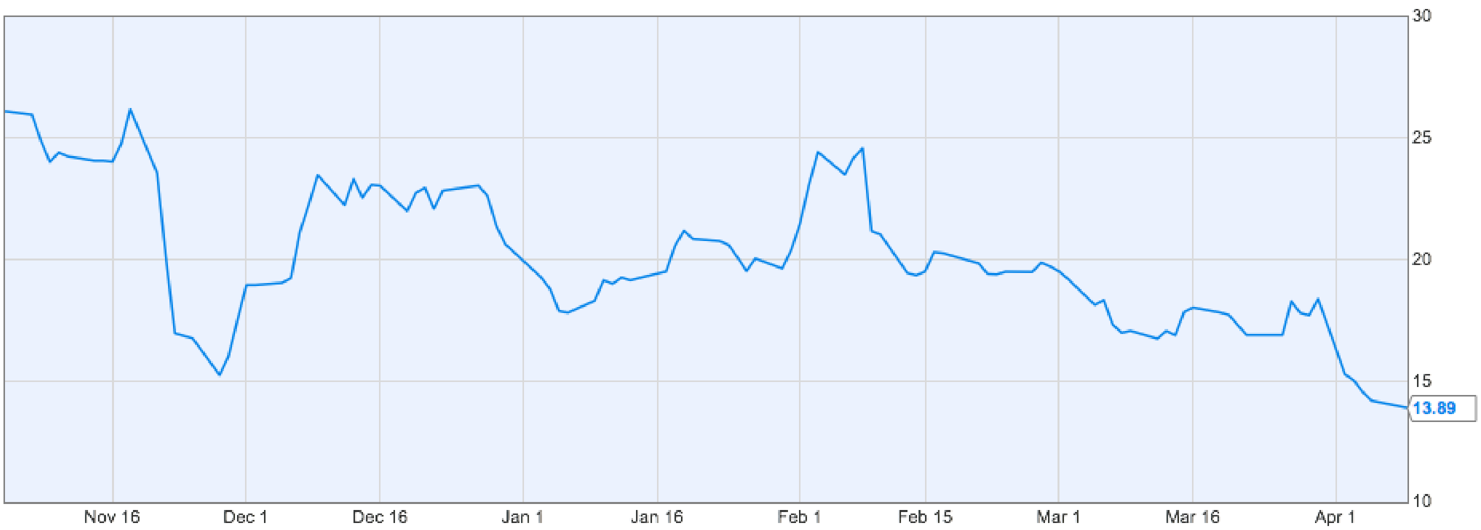
Not surprisingly, Groupon's subscriber growth rate has far outpaced the rate at which newly purchased Groupons have been redeemed (as many Groupons don't expire for a number of months), resulting in a time lag between new customer purchases and when the percentage owed to merchants is paid out. Therefore, Groupon's "free cash flow" is not 'free' after all. This phenomenon has caused some analysts to liken Groupon to a "Ponzi scheme." Attaining a positive free cash flow by subscriber growth is not sustainable, as markets will inevitably reach saturation.

Q4 Financials and Stock Performance

In Quarter 4 of 2011, Groupon was expected to post $475M in revenue and 3 cents per share in profit. On February 8, 2012, they reported higher-than-expected Q4 revenue at $506.5M, but still showed a net loss of $42.7M and a negative profit per share (-$0.08). On the bright side, cash and cash equivalents exceeded accounts payable for the first time. This fact quells the Ponzi scheme criticism, and it may be a signal to investors that Groupon may be on track to move towards bottom line profitability[x] – although it is far from a guarantee. Groupon also claims that the net income loss in Q4 2011 can largely be attributed to high international taxes.

After the relatively disappointing Q4 report, GRPN shares dropped 9.85% to $22.16 in after hours trading. Prior to Groupon's Q4 2011 financial report, GRPN share price had never sustained a price much higher than $26 (its initial IPO price was set at $20 per share), and since February, stock price has continued to drop to a price of around $17-19 per share in late March of 2012. In order for investor confidence to rise and stock price to grow, Groupon's Q1 2012 numbers must improve soon.

Groupon Stock Chart: From IPO to April 9, 2012



Source: http://ycharts.com/companies/GRPN/price

Unfortunately, Groupon faced additional controversy related to accounting practices at the beginning of April of 2012. Groupon did not originally report a large enough operating loss – the correction after this announcement decreased quarterly revenue by $14.3M and widened net income losses by $22.6M, or 4 cents per share.[xi] The increased losses came from a failure to fully report refunds given to unsatisfied customers. Since the announcement, Groupon's share price has plummeted to $13.89 (April 9, 2012). Investor confidence has been dropping for a while, but it seems that Groupon's most recent announcement has worn away at an already damaged trust in the company's ability to manage its financial reporting. There is now a serious risk of a class action lawsuit on behalf of investors, which would put additional financial pressure on the company.

Competitive Analysis

Porter's Five Forces Analysis

Threat of New Entrants	**High**
Internal Rivalry	**High**
Threat of Substitutes	**Low-Moderate**
Supplier Power	**Low**
Buyer Power	**Low**

Entry & Exit

Profitable markets will attract new entrants, which can reduce the profitability of existing players in the industry. Threat of new entrants is even more significant in markets where differentiation of products and customer loyalty are difficult to achieve. Groupon operates in such a market.

There are very few barriers to entry in the daily deal industry because the business is built upon a clever idea rather than major technological advancements. Almost all firms in this industry have very few patents significant to operations, which reduces the cost of entry. In addition, new entrants face virtually no compliance issues because the industry is new and highly unregulated. Moreover, the nature of the business determines that fixed assets, such as property, plant and equipment, are not necessary to establish a firm similar to Groupon. Thus, the set-up cost of this business is so little that it attracts a large number of entrepreneurs. Lastly, little specialized knowledge is required to enter the market. In fact, the business plan is so easy to replicate that it only takes a short amount of time for market entrants to begin operations.

The biggest concern for new market entrants is how to establish their initial customer base and merchant network. Because numerous players already exist in the market, many merchants have already set up daily deals with their select provider. Those merchants are unlikely to accept extra deals. However, new entrants usually will be able to build their merchant network by exploring new target markets based on market positioning and geographic location.

Due to the ease of entering the market, Groupon has faced increasing competition. Most likely, revenue growth will continue to shrink due to increasing options for consumers in the daily deal industry. This is why bottom line profitability is the number one priority for Groupon – once Groupon does show positive net income, it will be a continued struggle just to maintain profits without high subscriber growth.

It is easy for firms in the coupon industry to exit because the business has virtually zero fixed assets. Thus, the liquidation process should be fairly easy if a business is to be shut down. If an owner decides to sell their business, it would not be terribly difficult to find an interested party because the integration of merchant networks will probably generate economies of scale, or at least simply add merchants to a buyer's established network.

INTERNAL RIVALRY

The daily deal industry demonstrates extreme levels of competition. As of November of 2011, Yipit recorded 383 players in the daily deal industry. Groupon's largest competitor is LivingSocial, which offers customers one deal a day via email for their local areas. Other competitors include Google Offers, Amazon Local, and Saveology. There is also a segment of smaller, niche competitors like Gilt Groupe, who specializes in high-end fashion deals.

The competition in this industry is severe for a few reasons. First of all, it is very difficult for coupon dealers to differentiate their products. In theory, whoever offers the best discounts, best quality, and best selection of vendors should acquire and retain the most consumers. But with the development of websites such as Yipit, which aggregate the coupon deals offered by hundreds of coupon firms, it is very convenient for customers to compare the deals and choose the cheapest one. Because coupon deals offered by different firms are often nearly identical, it is almost impossible to create consumer loyalty within the current business model. High-frequency coupon users usually sign up for membership with multiple coupon dealers and simply choose the best deals regardless of which firm they are offered by. The increased number of market entrants makes the rivalry even more competitive over time.

This intense rivalry not only implies that Groupon will have to continue to offer appealing deals, but has also resulted much higher marketing costs in order to attract consumers with many daily deal options.

SUBSTITUTES & COMPLIMENTS

The main substitute that threatens Groupon and similar sites is discounts offered directly by merchants. These discounts are usually targeted at loyal customers who have purchased a large volume of products or services from one particular merchant. Essentially, Groupon provides an easy to run promotional campaign for merchants. But if merchants with enough consumer interest are able to run these deals without the help of Groupon, then self-run deals are a satisfactory replacement for running a daily deal through a third party. Merchant-run discounts may also be more lucrative for the merchant – there is no longer a third party taking a cut of the profit for providing the service of managing the deal's marketing, administrative, and logistical responsibilities.

While it is difficult to identify complements of Groupon, the relationship between Groupon and the merchants it cooperates with is complementary. As the aggregate demand for participating merchants' goods and services increase, the demand for Groupon is likely to increase as well.

SUPPLIER POWER

Since Groupon is not a manufacturer, the traditional definition of a supplier does not apply in our analysis. However, it makes sense to consider the merchants in the Groupon network their suppliers, because they provide goods and services that can be regarded as the "raw materials" for Groupon's final product – deals offered to subscribers. Supplier power in this case is low first because there are many potential suppliers. One individual supplier does not have a strong influence on the price-per-deal Groupon is willing to pay out to merchants, since Groupon can easily switch to other suppliers. Furthermore, since Groupon, just like other coupon firms, try to localize their deals, the merchants in the network are usually local and small in size, which also contributes to the low supplier power. On the other hand, although the suppliers have low bargaining power, they do have the absolute right to stay out of the game. This forces Groupon to offer deals that are reasonable to most merchants and requires that daily deals prove to be a worthwhile business investment for merchants in the long run.

Some people consider advertisers the suppliers, because advertising is a critical component and input of the coupon business. For similar reasons as above, we conclude that supplier power is also low in this case.

BUYER POWER

We consider customers who purchase Groupons as buyers. While an individual buyer has no bargaining power, meaning they can only accept the deals or prices offered if they choose to use Groupon, they have significant power as a group. The entire customer base behaves in a nearly identical way, that is, their incentives are only driven by prices and quality. Thus, if Groupon does not offer attractive prices, the quantity demanded will decline quickly. Since it is hard for Groupon to differentiate products and retain loyal customers, customers might easily stop using Groupon or choose their competitors' offers with no switching costs. Therefore, Groupon has to respect the aggregate buyer power from the entire customer base.

SWOT Analysis

Strengths, Weaknesses, Opportunities, Threats

Strengths	Weaknesses
• Large Subscriber Base • Access to International Markets • Resources for Innovation • Employee Manpower	• Reliance Upon Rapid Subscriber Acquisition for Revenue Growth • Lack of Differentiation • Difficulties with Growth
Opportunities	**Threats**
• Transition to Mobile Platform • Increasingly Targeted Marketing • Enhancement of Merchant Experience	• Large and Well Funded Competitors with Similar Offerings • High Number of Niche Competitors • Waning Customer Activity

Strengths

Large Subscriber Base: Due to Groupon's astounding growth in the last few years, they have acquired a subscriber base much larger than their competitors. Clearly, this is a primary goal in the Daily Deal industry. On the other hand, it is unclear whether or not there will be significant first mover advantages in acquiring many customers quickly, as switching costs are currently very low.

Access to International Markets: Through continued acquisition of foreign Daily Deal sites that have emulated Groupon's business model, they have been able to capitalize on markets that are relatively untouched. While this may provide additional revenue for the time being, it may only be a positive in the short or medium run as competitors begin to exploit international markets more fully.

Resources for Innovation: Because Groupon has established a large customer base, sizeable network of merchants, and large number of markets around the world, they have opened doors for the testing and implementation of innovative approaches to the daily deal game. We believe this to be an extremely valuable asset. Recently, Groupon has begun rolling out a new offering to subscribers called Groupon VIP. Jeff Holden, Senior VP of Product Development, said, "In the case of VIP, we asked our customers 'If you could wave a magic wand and change Groupon in any way, what would you ask for?' The three main features of VIP were at the top of the list: early access to deals, ability to purchase closed or sold out deals and anytime-refunds."[xii] A premium membership is not new for daily deals – LivingSocial has been testing LivingSocial Plus – but Groupon VIP varies in the details. Because of Groupon's large number of markets, they are able to test products before presenting them to the entire subscriber base. In addition, 'Groupon Now' would not be a possibility without a large number of merchants and enough subscribers within markets offering 'Now' deals.

Employee Manpower: While Facebook's employee count was less than 100 after two years, and around 2,000 in early 2011, Groupon ended 2010 with over 4,000 employees. Considering it had ended the year before with just 120 employees, its growth in personnel was considerably larger than most 'tech' companies. The process for facilitating daily deals with each individual merchant, however, warrants a high employee count. In order to communicate and establish satisfactory deals with individual merchants, personal contact is a must, and Groupon has no lack of manpower. The rapid growth in numbers does however pose problems, which will be addressed in Groupon's weaknesses.

WEAKNESSES

Reliance Upon Rapid Subscriber Growth for Revenue Growth: Although many analysts expected Groupon to show a positive net income for the first time in Q4 2011, the company was unable to attain that goal. As explained in our financial analysis, Groupon has been able to grow revenues and display positive cash flow mainly through rapid expansion into new markets and high marketing costs. The sustainability of this strategy is doubtful and is Groupon's most glaring weakness in the long run, so the company must find ways increase profitability within existing markets in order to show positive net income.

Lack of Differentiation: Trouble differentiating is not just Groupon's problem, but as a Daily Deal industry leader it is especially important in order to hold onto existing customers. Currently, products and services are continually being tested that will attempt to separate Groupon's service from their competitors. While the results have yet to be seen, there are some promising additions that will be addressed in the 'Opportunities' section of this analysis.

Difficulties with Growth: Quality issues arose as Groupon's employee count grew. Service failures were recorded, as well as deals that led to high customer and merchant dissatisfaction. The management of these issues became more difficult as more deals were being run and there were more employees requiring training and integration. Groupon has dealt with some of these issues by increasing its customer service organization to over 1,000 employees and by releasing services to create a more user-friendly merchant experience (to be discussed in the 'Opportunities' section as well).

OPPORTUNITIES

Transition to Mobile: The opportunity to transition Groupon to a mobile platform is promising, and has been a main premise of Groupon's strategy moving forward. Groupon Now is a mobile application that would allow the purchase and use of same-day-deals according to the location of the user. Instead of purchasing a deal ahead of time, the mobile user will search for a deal on food or an activity that is both nearby and must be used that day. The introduction of Groupon Now is underway, but the effects have not been seen on Groupon's income statement. The hope is that if there are enough deals and they are easily accessible, users will be more likely to use deals on a whim. Again, the opportunity of a transition to mobile is only possible because of Groupon's large number of participating merchants.

Increasingly Targeted Marketing: Making sure that the right deals are reaching the right customers is extremely important in converting marketing into sales. Groupon has the opportunity to continue to attract subscribers and non-subscribers simply by providing a more extensive selection of deals. But more importantly, Groupon must continue to provide a wide selection *and* be sure that deals tailored to each customer base somehow reach those customers. Of course, sending emails to customers based on their previous daily deal purchase history is a must, but Groupon can take this further. On March 16, 2012, the Groupon Reserve program began in Los Angeles. This program attempts to target higher end customers and entice them to sign up for the "Reserve List." These deals will provide discounts on luxurious, more expensive offerings that the average Groupon subscriber would be less likely to purchase. The company website also offers Groupon Getaways, or discounted vacation listings, and Groupon Goods, or deals on merchandise. Again, these offerings provide a wider selection, but because Groupon has a large subscriber base, they have the opportunity to use email to directly target those that may be interested in certain deals. This will require gathering more information on consumer trends and individual consumer preferences – an important part of differentiating Groupon's service. We will address targeting marketing in more detail in our final recommendations.

Enhancement of Merchant Experience: As the number of merchants participating grows, it will be increasingly important to maintain a level of quality in daily deal offerings. One way to encourage quality merchants to join is by providing a quality experience for each merchant. The most recent example of this is the March 19 release of Groupon's scheduling tool for merchants. Using this software, appointment-based merchants (massages, haircuts, guided tours, etc.) have the opportunity to more easily book and organize upcoming customers. The service is free for those using Groupon, and free in the next 3 months for merchants who are not using Groupon. If certain merchants lose interest in running daily deals, Groupon may need to consolidate its focus on those that are most attainable. This may mean a shift towards running deals with merchants that are more likely to benefit from a daily deal: experience goods or services, high margin goods or services, and newly established businesses that hope for an initial boost in customer awareness.

THREATS

Large and Well Funded Competitors with Similar Offerings: Although Groupon is larger than any competitors, there are a number of them that pose a serious threat to market share. LivingSocial is the second largest daily deal site, and Amazon Local has recently gained serious traction. Google Offers is also an example of a daily deal site that has no lack of financial stability. Because there are yet to be considerable differences between these deal sites in the consumer's eyes, they pose a significant threat to Groupon's market share. Daily deal aggregators like YiPit allow consumers easy access to deals from all of these companies, further reducing switching costs for consumers.

High Number of Niche Competitors: With minimal startup costs, it doesn't require a large competitor to take a bite out of Groupon's profits. A high number of small daily deal sites tailoring to niche markets can have a significant impact. These smaller sites may even benefit from specialization – with a focus on a specific type of good or service, consumers who demand those goods may look to a niche daily deal site for more variety within a specific realm.

Waning Customer Activity: As Groupon's subscriber base grows, it seems that customer activity is declining. This may be due to a higher volume of 'lower quality' subscribers, or less active users. The average Groupon user spent $18 in the first half of 2011, which was three dollars less than the same time period in 2010. While the enormous increase in subscribers from 2010 to 2011 created revenue growth, bottom line profitability has yet to be seen. If customers continue to decline in value, it will make profitability even more difficult.

STRATEGIC RECOMMENDATIONS

Groupon is facing significant obstacles that have analysts doubting the company's future growth prospects and financial stability. We believe that the company is at a crucial turning point – subscriber growth is slowing but they are not yet profitable. In order to address the strategic issues discussed in this report, we have formulated a forward-looking strategy.

While subscriber acquisition has been important for revenue growth and in gaining a large initial share of the market, our recommendations take a different approach – we believe it is now time to pull back from an aggressive topline growth strategy and begin focusing on sustainability. Our main recommendations are to aggressively prepare for decreasing subscriber growth, increase current customer base activity, and continue to enhance the merchant experience.

PLAN TO MAXIMIZE IN THE FACE OF SLOWING GROWTH

Year 2010	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Subscribers	3,434,610	10,445,521	21,369,608	50,583,805
Gross Billings	44,383,000	91,424,000	194,272,00	415,269,000
Revenue Per Subscriber	*13.02	*8.75	*9.09	*8.21
Year 2011	**1st Quarter**	**2nd Quarter**	**3rd Quarter**	**4th Quarter**
Subscribers	83,100,006	115,717,299	142,865,836	150,000,000
Gross Billings	668,174,000	929,249,000	$1.157 billion	$1.25 billion
Revenue Per Subscriber	$8.05	$8.03	$8.11	$8.33

Source: http://seekingalpha.com/article/352851-after-abysmal-earnings-the-time-to-short-groupon-is-now

Groupon's subscriber growth rate is declining. Of course, subscriber growth should be expected to cool off after Groupon's extreme increase in subscribers in 2010 and 2011, but since the first quarter of 2010, subscriber growth has shown the following sequential growth per quarter: 300%, 200%, 237%, 64%, 39%, 23%, and 5%.[xiii]

The latest drop off in growth numbers is large, and should be a signal to Groupon that reliance upon extreme subscriber growth is no longer an option, especially since total subscriber acquisition costs have not significantly decreased over the same time period. There are two key steps that will help to increase profitability in the short run, and set the stage for long run profitability.

In the short run, Groupon must decrease marketing costs. Simply dedicating less revenue to subscriber acquisition will achieve this goal. As a percentage of revenue, Groupon's marketing costs were 31.5% of revenue in Q4 2011.[xiv] We recommend a target percentage of revenue of less than 20%. Even after the most recent accounting adjustments, Groupon would have seen a positive net income last quarter had the company achieved this goal. While the decision to decrease marketing costs will reduce future subscriber acquisition, we believe the benefits of decreasing costs outweigh the marginal loss in subscriber growth.

For a longer-term chance at profitability, Groupon must take steps to maximize profits by choosing the most effective strategies moving forward. It is difficult to definitively say what those strategies will be within such a new industry and without sufficient historical data. Therefore, we recommend Groupon begin a project of data mining and intensive analytics on the following:

-Highly profitable markets and their characteristics

-The most successful categories of daily deal offerings

-Empirical data on active subscribers

-Results of new product/service testing rollouts

As stated before, we believe that Groupon's large number of subscribers worldwide, in itself, is a very valuable resource. In order to effectively engage more of their customers, Groupon must gain a greater understanding of the drivers of subscriber activity – market characteristics, merchant types, and even subscriber demographics. Once Groupon has a clearer picture of the most profitable segments, the company will be able to choose a distribution of subscriber acquisition costs that will provide a higher return per dollar spent.

ACTIVELY DIFFERENTIATE

Groupon has succeeded in providing a large network of merchant deals to a large base of global consumers. This success has been a result of extreme growth in size largely through the acquisition of local daily deal sites, and at the cost of bottom line losses due to extreme subscriber acquisition costs and international taxes. But, there are many companies offering similar daily deal services to consumers. At this point, Groupon is offering a fundamentally identical product at a much larger scale than competitors.

Groupon's service as it stands will not be enough to increase customer activity and create a strong loyalty among Groupon subscribers. Groupon must double efforts to provide the best consumer experience in the industry. Generally, we see short-mid term opportunity in three areas: transition to a mobile platform, rewards programs to encourage repeat Groupon purchases, and increasingly targeted marketing. Although there have been no official reports on the success seen in any of these areas so far, Groupon should actively and aggressively pursue continued rollouts of multiple variations of these programs.

The transition to a mobile platform is probably the most costly opportunity to pursue, but Groupon believes that it is a worthwhile investment – they have already begun the deployment of Groupon Now. A rewards program can be implemented at little cost and tested in smaller markets before widespread use. A rewards program would provide active subscribers with an incentive to purchase more Groupons, either with a voucher for a discount on future purchases, or a total points system similar to an airline's mileage program. Targeted marketing, or marketing toward existing subscribers based on their likely preferences, should also prove to be inexpensive. Basing targeted marketing solely on Groupon subscriber purchase activity is not enough – Groupon cannot effectively market based on so little information. It is very inexpensive to reach out to current subscribers by email, but the main task will be gathering enough information about consumers to effectively market deals they are most likely to purchase. This can be carried out through surveys and more effective tracking of subscriber activity, while being mindful of consumer perception with regards to both privacy and convenience. It would be very beneficial if Groupon can limit the total volume of emails sent, while increasing the number of sale conversions per email. It is no longer acceptable to send an email titled "deals for kid friendly fun!" to a 22 year old, single Pomona College student, for example.

Continually Enhance the Merchant Experience

In November of 2011, Need a Cake Bakery owner Rachel Brown found herself with 102,000 cupcake orders at 75% off of retail price. Just to complete the orders, she had to hire temporary workers. By the end of her Groupon daily deal experience, she was knee deep in debt.[xv] While this is an extreme example, many merchants have found themselves dissatisfied with the Groupon experience, and this is simply unacceptable.

Tailoring every Groupon perfectly to individual merchants' needs is unrealistic, but it is important provide information and guidelines that allow merchants to understand the potential volume of orders and how to fulfill demand. In addition, Groupon must guide merchants within specific industries on best practices to encourage return customers after a deal – this could mean handing out promotional items to every Groupon redeemer, signing them up for an email list, etc. A Groupon Rewards program along with other incentives to buy more daily deals will also be an inherent benefit of Groupon deals. American Apparel saw one of Groupon's more successful daily deal programs – after selling 133,000 vouchers, customers spent an average of $20 more than the face value of the coupon, and American Apparel managed to convert 25% of Groupon customers into email subscribers, an extremely effective marketing tool as an extension of a daily deal.[xvi]

In moving forward with Groupon's intensive analytics program, we recommend that the company pay special attention to the types of merchants that have the most success with daily deals. Our hypothesis is that there are three types of merchants that will see the most success in running a daily deal: newly established businesses, those that sell 'experience goods,' and merchants that already show a high margin on promoted products. A Groupon deal has the ability to awareness of local merchants, and those that have been recently established will see the most benefit – most customers who participate in a daily deal with these companies will not be existing customers who would have purchased goods anyway at paid full price. On the same note, merchants that sell 'experience goods,' or goods that require consumers to try them before they can fully understand quality and characteristics (e.g. test driving a car), will also benefit from a large group experiencing their goods and potentially spreading the word to friends. Lastly, a company that already sees high margins from sales will not be as negatively affected by the drastic discounts Groupon offers, yet will see all the benefits of a promotional daily deal program. If a merchant does not fall into any of these categories, special attention may need to be paid to make sure that the experience ends up a successful one.

Conclusion

Groupon faces a competitive environment and financial challenges well beyond those of market leaders in other industries. Much has yet to be revealed in terms of consumer tastes and whether overall interest will increase, level off, or decline from both the consumer and the merchant side. We believe that there are a number of worrisome indicators in the daily deal industry that warrant an extremely aggressive strategy of product improvement and profit maximization, while continuing to provide a service that can be counted on by consumers and merchants alike.

[i] http://quote.morningstar.com/stock-filing/Annual-Report/2011/12/31/t.aspx?t=XNAS:GRPN&ft=10-K&d=184f3723dba0992f583bf8391bdf43eb

[ii] Groupon 10-K Annual Report, 2011, pp 3. http://quote.morningstar.com/stock-filing/Annual-Report/2011/12/31/t.aspx?t=XNAS:GRPN&ft=10-K&d=184f3723dba0992f583bf8391bdf43eb

[iii] http://bits.blogs.nytimes.com/2012/02/17/groupon-nabs-hyperpublic-a-local-data-start-up/

[iv] http://www.suntimes.com/business/10029857-420/groupon-founder-admits-bush-league-mistakes-on-60-minutes.html

[v] Groupon 10-K Annual Report, 2011, pp 42. http://quote.morningstar.com/stock-filing/Annual-Report/2011/12/31/t.aspx?t=XNAS:GRPN&ft=10-K&d=184f3723dba0992f583bf8391bdf43eb

[vi] http://www.cnbc.com/id/45153323/Groupon_s_Got_Problems_Massive_Competition

[vii] http://wallstcheatsheet.com/stocks/your-cheat-sheet-to-groupons-implosion.html/

[viii] Groupon 10-K Annual Report, 2011, pp 41. http://quote.morningstar.com/stock-filing/Annual-Report/2011/12/31/t.aspx?t=XNAS:GRPN&ft=10-K&d=184f3723dba0992f583bf8391bdf43eb

[ix] Groupon 10-K Annual Report, 2011, pp 50. http://quote.morningstar.com/stock-filing/Annual-Report/2011/12/31/t.aspx?t=XNAS:GRPN&ft=10-K&d=184f3723dba0992f583bf8391bdf43eb

[x] http://seekingalpha.com/article/358451-groupon-rights-the-ship-take-profits-in-short-positions

[xi] http://news.yahoo.com/groupon-says-4th-quarter-weaker-reported-232543593.html

[xii] http://finance.yahoo.com/news/groupon-expands-test-vip-loyalty-215800447.html

[xiii] http://seekingalpha.com/article/352851-after-abysmal-earnings-the-time-to-short-groupon-is-now

[xiv] Groupon 10-K Annual Report, 2011, pp 8. http://quote.morningstar.com/stock-filing/Annual-Report/2011/12/31/t.aspx?t=XNAS:GRPN&ft=10-K&d=184f3723dba0992f583bf8391bdf43eb

[xv] http://wallstcheatsheet.com/stocks/your-cheat-sheet-to-groupons-implosion.html/

[xvi] Gupta, Sunil. Weaver, Ray. Rood, Dharmishta. Groupon Strategy Report. Harvard Business School. September 21, 2011.