CASE ASSIGNMENT: Groupon vs. LivingSocial

Coupon Wars

On January 20, 2011, many online consumers were presented with a deal that at face value might sound too good to be true. Recipients registering at the site could pay $10 and receive a $20 Amazon gift card. And if that alone wasn't motive enough, LivingSocial threw out a further incentive: If a buyer got three friends to purchase the deal as well, he or she would receive the gift card for free.

Many savvy consumers in fact would probably already be familiar with sites like LivingSocial and the deals it offers. As the second largest online deal-a-day Web site, LivingSocial is one of numerous similar startup sites playing catch-up to market leader Groupon. The model for such Web sites is relatively straightforward, as they function roughly as marketing vehicles for local small businesses, generating publicity and facilitating transactions. The site, says Groupon, would initiate coupon offerings geographically (based on city) by working out deals with local retailers, restaurants, and other businesses. Discounts can be significant, ranging from 50 percent to as much as 90 percent off. Businesses would sell the coupons to consumers directly, and as the go-between, Groupon would take a cut, usually about 30 percent after the discount.

So how does a $20 Amazon gift card for $10 fit into the equation, especially since Amazon wouldn't exactly qualify as a "small local business"? As an added twist, LivingSocial and Amazon decided to forgo the typical sales arrangement; LivingSocial purchased the gift cards from Amazon and sold them directly. And although the terms of the exchange were not disclosed, if LivingSocial purchased them at face value, it would certainly absorb the losses itself. But if LivingSocial takes such a heavy loss on the deal, how would Amazon justify the $175 million investment it made in LivingSocial in December 2010, just before the gift card offer?

The answer lies within the 1.3 million coupons LivingSocial managed to sell through the promotion, which beat the $11 million in sales that rival Groupon generated when it offered a similar national deal with Gap. Prior to the deal, LivingSocial—valued at an estimated $1 billion—had 17 million members, compared to the 50 million subscribers of Groupon, which had recently turned down a $6 billion offer from Google. Now compare the 1.3 million Amazon gift cards to the average number of coupons that Groupon sold per deal over the first quarter of 2010. At only 1,848, it becomes pretty clear that national deals like Groupon's Gap coupon and the Amazon gift cards are not about driving sales for Gap and Amazon, nor are they about profitability. They're about driving sales volume, increasing name exposure, and pulling in new members.

According to Caris & Company analyst Sandeep Aggarwal, "These companies are in a land grabbing stage; the more members they sign up, the better deals they bring in. It clearly helps them generate higher revenue." So for a company like LivingSocial trying to play catch-up to market leader Groupon, a high-profile national deal like the Amazon offer makes sense. In December 2010, Groupon held a commanding lead over other group coupon sites in terms of its share of total U.S. site visits, leading second place LivingSocial by almost a full order of magnitude (0.033 percent to 0.0036 percent).

This land grab stage becomes increasingly important as there is clearly still room to grow. From Q4 of 2009 to Q1 of 2010, Groupon saw significant growth in nearly every major sales metric, from average buyers per deal (111 percent), to average deal price ($27.20 to $38.36), to average gross per sale (102 percent). Unique visitors rose from 900,000 in September 2009 to three million in March 2010. So while Groupon may have huge a head start, other companies can still find deals to attract significant attention. Barriers to entry remain low, with minimal existing technological advantages and little preventing local vendors or buyers from using multiple platforms. And as neither Groupon nor LivingSocial have reported seeing subscriber fatigue from receiving daily deal advertisements, the distribution model remains viable. How long this will last, however, is an entirely different question, making moves to grab subscribers (such as LivingSocial's Amazon deal) all the more important.

Sources: Steven Carpenter, "A TC Teardown: What Makes Groupon Tick," *TechCrunch,* May 2, 2010, http://techcrunch.com/2010/05/02/teardown-groupon; Claire Cain Miller, "LivingSocial Gets Attention for Amazon Discount," *New York Times*, January 19, 2011, http://bits.blogs.nytimes.com/2011/01/19/livingsocial-gets-attention-for-amazon-discount/?scp=1&sq=livingsocial&st=cse; Chris Crum, "Groupon Dominates LivingSocial in Market Share, but Now Amazon's in the Equation," *WebProNews*, December 3, 2010, www.webpronews.com/topnews/2010/12/03/groupon-dominates-livingsocial-in-market-share-but-now-amazons-in-the-equation; Street Signs, "Living Social," *CNBC* Web site, January 20, 2011, www.cnbc.com/id/15840232?video=1754695205&play=1; *Wall Street Journal Digital Network*, "Digits: LivingSocial Looks to Out-Deal Groupon," Wall Street Journal, January 20, 2011, http://online.wsj.com/video/digits-livingsocial-looks-to-outdeal-groupon/A16D982C-EBEC-43ED-B0B5-6D5FD76B21FB.html.