

You're the Boss



The Art of Running a Small Business

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Is Groupon Ruining Retailing?

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Thinking
Entrepreneur

Recently, a 30-year-old woman came into my custom framing business with a designer purse and a question, “What kind of coupons do you have out there?”

It is indeed a new world. Thanks mostly to [Groupon](#), which is based about two miles from my framing business, this social coupon craze has become a big thing. For retailers, the question is whether it’s a good thing or bad thing. The coupons can drive an awful lot of people into your store, but not every store is prepared for the onslaught. And there’s another issue, one that has gotten less attention: the daily-deal sites are also training people to expect that they can get a coupon for almost anything.

Groupon didn’t invent this problem. There have been coupons all over the Internet for years, but it’s getting worse. As Jessica Bruder [wrote](#) in The Times last week, there are hundreds of companies chasing Groupon, many hoping to create a regional niche or a product niche. I suspect there will soon be a shakeout among these Groupon clones, but for now, the upshot is that most small businesses that sell a product or service are getting deluged with offers to partner with one or more of the coupon sites. Those offers are producing a lot of confusion and anxiety for businesses. To deal or not to deal, that is the question.

In a previous [post](#), I emphasized that Groupon is advertising and while you don’t pay anything up front, it can be very expensive advertising. I went through the math that I suggest small businesses use to try to figure out whether social coupons make sense for them. There are many variables, including whether a customer spends more than the face value of the coupon, how many existing customers purchase a coupon, what percentage of the discount customers become regular customers, how many coupons are sold to each customer and the true cost of delivering the additional sales driven by the coupons.

The difficulty is in determining — or in some cases guessing — what these numbers will be. It’s been two years since I used Groupon at my frame shop. Few of the sales have turned into repeat customers, which is not typical of my business — we have a

percentage of repeat customers. And that's one reason I am concerned about the potential damage a daily deal can do to a company's brand. The deals are a threat to what I call price integrity.

When you charge some customers full price and others half price, you make some happy and others unhappy. Worst of all, you make the wrong customers happy! The regulars are unhappy because they feel they overpaid; the discount customers are happy — but they're probably not coming back because they're used to shopping at half price. When you decide to do a daily deal, you are training your existing customers to wait for the next coupon. Does that sound like a recipe for success?

It has been noted that this kind of promotion works best for a business that has big fixed costs but low, if any, variable costs — a yoga class, for example. Whether there are 5 people in a class, or 20, the cost of delivering the service is basically the same. There is, however, a potential for conversion. You risk converting an existing customer into a coupon customer. Or, you may even replace a full-price customer with a coupon customer because you have exceeded capacity.

Let's do the math on a simple example. A yoga class charges \$20 per person and can take 20 students. The class has been averaging 14 people at \$20 each, or \$280 per class. The owner decides to run a daily deal to fill the class and attract new customers. It works splendidly.

The class is now filled. There are now 10 people paying \$20 each (two regulars bought coupons and two regulars signed up too late and got bounced). Ten people pay \$10 each, revenue that is split 50/50 with the deal site. That means the total for the class is \$200 from the full-price customers plus \$50 from the coupon customers, which equals \$250. The studio is busier, the parking lot is full, but the cash drawer holds fewer dollars — 30 fewer in fact. That might not sound like a lot but that's 10 percent of sales, which might represent the company's entire profit. What's good for the customer could prove fatal to the business.

The scary thing about this scenario is that it's something of a best-case scenario. The coupon sales didn't generate additional expense for the yoga business (the way they would for, say, a restaurant); the numbers could be far worse for a business that is selling a product or service. Busier does not necessarily mean more profitable.

Of course, the deal could still pay off if the new customers turn into repeat customers. Will they? Maybe. But a typical new customer is gained because a business is near the customer's home or office, or because the customer heard something good about the business, or because the customer needed the product or service. These sales were generated because of a deal. Maybe the customers will move on to the next yoga studio that offers a coupon deal — or maybe they will decide not to try yoga again, especially not at full price. And how many existing customers did the yoga studio lose by doing the deal?

I recently spoke to about 150 retailers at a trade convention. One of the board members of the trade association asked the retailers if they had used Groupon. One person in the audience said he had used a competitor and was satisfied with the results. No one in the room asked the important follow-up question, so I asked it: “What was your average sale to the coupon customers?” He said it was a good bit higher than the face value of the coupon, which is probably why he came out O.K. on the deal. But how many times can he do it without damaging his brand?

The board member then asked the crowd, “Who thinks that Groupon will be out of business in three years?” Almost every hand went up. They are wrong. Groupon is here to stay. Daily deal coupons are here to stay. I’m sure they work for some businesses. Lots of businesses will try them at least once — and there are lots of businesses out there. But all of us, even those of us who never try a daily deal, will have to accept that we are training customers to believe that the next discount coupon is always an e-mail away.

Over time, I think the competition from all of the Groupon clones may force the deal sites to let the retailers keep a higher percentage of the coupon split. Perhaps the discount to the customers will go down, as well. And then maybe daily deal sites will work for more businesses as well as for the customers and the coupon sites.

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