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SECTION E

General Issues in Strategic Management

Industry Two—Entertainment and Leisure

CASE 11

Groupon, Inc.

DAILY DEAL OR LASTING SUCCESS?

Nick Falcone, Eric Halbruner, Ellie A. Fogarty, and Joyce Vincelette



Andrew Mason sat in his office in Chicago, Illinois, thinking about the city. His adult life began there—he graduated from Northwestern in 2003. His business originated there not long after—Groupon began as a local Chicago discount service and became a global phenomenon seemingly overnight. Mason knew that Groupon was a great idea. The company was the first of its kind and changed the way consumers spend, shop, and think about discounts. But how could Groupon, based in such innovation and having experienced such exceptional growth, be in such a precarious position? A wave of competition had swelled, including the likes of technology giants and both general and niche daily deals services, all replicating Groupon's business model. How could Groupon compete against large companies and their expansive resources? Would consumers and merchant partners flock to other services that better suited their needs? Mason worried about the increasingly downward trajectory of Groupon's stock price since the company's initial public offering. The year 2012 had brought additional scrutiny of Groupon from the SEC, as well as the unfortunate title of Worst CEO of 2012 for Mason.¹ He thought about the barrage of competition facing his firm and the related questions regarding the sustainability of its business model. Groupon was a star as it grew from its Illinois roots, but it now had problems on a global scale. Mason looked out his window over the city where it all started, nostalgic for a time when business was easier and wondered what to do.

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History

In 2006, three years after graduating from Northwestern University with a degree in Music, Andrew Mason became frustrated when trying to cancel a cell phone contract. He thought about the likely large group of people in similar circumstances and figured "if [he and they] were united in some way, [they] could leverage [their] collective power."² He began developing a Web platform based on the "tipping point" principle (the number at which an idea or cause reaches critical mass, popularized by Malcolm Gladwell) that would utilize social media to organize collective action.³ The company he created was aptly named ThePoint and was designed to be a tool for raising money for various causes. The "tipping point" for

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a particular cause, which would be set by the fundraiser, was a certain amount of money or signatures needed for the plan to become active.⁴ Users could donate with minimal risk because credit cards were not charged unless and until the threshold was met and the cause “tipped.”

But ThePoint lacked the focus necessary to survive on its own. “The big problem. . .” Mason said, “is that it’s this huge, abstract idea. You can use this platform to do anything from boycotting a multinational company to getting 20% off a subscription to *The Economist* . . . we needed to pick one application of the larger abstract idea and execute it really, really well.”⁵ The service was too broad to achieve success, but the tipping point element had noticeable potential.

Mason found his “one application” in the most effective campaigns on The Point—those that gave a group of consumers buying power.⁶ He began recruiting merchants to offer discounts in online deals that centered on the tipping point principle. In deals that tipped (when enough coupons were purchased), consumers saved money and merchants benefitted from both large-scale sales and market exposure. The concept grew into an entirely new venture: a daily deals service that relied on the power of groups. Groupon—the name is a combination of the words “group” and “coupon”—launched its first deal in October 2008: Buy two pizzas for the price of one from the Motel Bar, located on the first floor of Groupon’s Chicago headquarters.⁷

From there, the company grew at an unprecedented rate. In six months, Groupon parlayed its 5000-person Chicago e-mail list into daily deals operations in Boston, New York, and Washington, DC. Groupon’s estimated worth was over US\$1 billion after just 16 months in business, becoming the second-fastest website to reach that milestone (YouTube reached the mark in 12 months).⁸ By 2010, Groupon was serving more than 150 markets in North America, 100 markets in Europe, Asia, and South America, and was boasting 35 million registered users.⁹ *Forbes* magazine declared Groupon to be the “fastest growing company ever”¹⁰ in August 2010 and Groupon rejected a US\$6 billion acquisition offer from technology giant Google in December of the same year.¹¹

In November 2011, the company raised US\$700 million in its initial public offering, the largest IPO by a United States Internet company since Google’s US\$1.7 billion in 2004.¹² But the growth seen in the company’s infancy had been largely elusive since its IPO. In the 10 subsequent months, Groupon’s stock fell 84% from US\$26.11 to close at US\$4.15 on August 31, 2012.

Business Model

Groupon described itself as “a local commerce marketplace that connects merchants to consumers by offering goods and services at a discount.”¹³ The company saw opportunity in bringing the brick-and-mortar world of local commerce onto the Internet, which it said was creating a new way for local merchant partners to attract customers.¹⁴ The “Groupon Promise” was core to the company’s customer-service philosophy:

We’re confident in the businesses we feature on Groupon and back them with the Groupon Promise. If the experience using your Groupon ever lets you down, we’ll make it right or return your purchase. Simple as that.¹⁵

Groupon followed specific processes in dealings with consumers and merchants to keep its promise. The company used its technology and scale to target relevant deals based on individual customer preferences.¹⁶ Deals were disseminated primarily via e-mail; consumers subscribed to Groupon’s mailing list, chose their locations, and were sent information on deals in their areas. Groupon’s mobile application and website were set up to distribute deals to current and potential customers based on proximity to the sponsoring merchant partner.¹⁷ Customers purchased coupons online, which became active only when a deal reached its predetermined critical number of purchases. The coupons had expiration dates.



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Merchants wishing to partner with Groupon and feature their products or services in deals were vetted by the company. Only one in eight applicants was accepted. Winning merchants had to be receiving praise on review sites like Yelp, CitySearch, and TripAdvisor, and their Groupon deals had to offer a substantial discount from normal prices and not be similar to other promotions regularly offered by the vendor.¹⁸ A merchant partner signed a contract that specified the percentage of revenue Groupon would collect from a deal (typically 50%) and the number of coupons that would have to be purchased for a deal to “tip” and for the discount to become active. Groupon collected revenue from the deals immediately and made payments to merchants over a 60-day period.¹⁹

Merchants were not completely at ease with the general model, now utilized by other deal providers, citing the heavy discounts required and low repeat rates from customers as their two biggest concerns.²⁰ Twenty-three percent of respondents to a merchant survey on daily deals companies said that the discounts were their biggest concern, but 45% said they acquired more customers as a result of offering the promotions.²¹ Eighty percent were satisfied with daily-deal companies. Merchant satisfaction and retention were critical to Groupon’s strategy for success.

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Mission and Strategy

CEO Andrew Mason explained his vision for Groupon in a 2011 Letter to Stockholders. Upon the shoulders of its business model, he wrote, Groupon was setting out to reinvent the multitrillion-dollar local commerce ecosystem. “Today, Groupon is a marketing tool that connects consumers and merchants. Tomorrow, we aim to move upstream and serve as the entry point for local transactions.” Groupon’s mission, according to Mason, was “to become the operating system for local commerce.”²²

Groupon’s objective was to become an essential part of everyday local commerce for consumers and merchants. Key elements of its strategy included the following:²³

- **Grow subscriber and customer base.** Groupon made significant investments to acquire subscribers through online marketing initiatives, such as search engine marketing, display advertisements, referral programs, and affiliate marketing. In addition, Groupon’s subscriber base increased by word of mouth. The company intended to continue to invest in acquiring subscribers; however, it continued to shift its efforts toward converting subscribers into customers who purchase Groupons. Groupon’s investment in the growth of its subscriber base and achieving optimal subscriber levels was directly linked to the breadth and location of its merchant partners. As such, while the number of total subscribers was a key metric to measure Groupon’s progression over the long term, it was not a key operational metric in the same manner as was the active customer base.
- **Grow the number of merchant partners.** Groupon expanded the number of ways in which consumers could discover deals through its marketplace. The company made significant investments in its sales force, which built merchant partner relationships and local expertise. Merchant partner retention efforts were focused on providing merchant partners with a positive experience by offering targeted placement of their deals to the subscriber base, high-quality customer service, and tools to manage deals more effectively. Groupon routinely solicited feedback from merchant partners to ensure their objectives were met and they were satisfied with its services. Based on this feedback, Groupon believed that merchant partners considered the profitability of the immediate deal, potential revenue generated by repeat customers, and increased brand awareness for the merchant partner and the resulting revenue stream that brand awareness might generate over time. Some merchant partners viewed deals as a marketing expense and might be willing to offer deals with little or no immediate profitability in an effort to gain future customers and increased brand awareness.

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- Position Groupon to benefit from technological changes that may affect consumer behavior. Groupon believed that as technological advances continued, particularly with the proliferation of affordable Smartphones and tablet computers, the ways in which customers and local merchant partners interacted would change significantly. For example, in December 2011, one quarter of all purchases in its North America segment were made through mobile devices. Groupon believed that it was well positioned to benefit from, and to drive, these changes. The company continued to invest heavily in technology, including through acquisitions.
- Increase the number and variety of products through innovation. Groupon launched a variety of new products in 2011 and planned to continue to launch new products to increase the number of customers and merchant partners transacting business through its marketplace. As its local commerce marketplace grew, Groupon believed that consumers would use Groupon not only as a discovery tool for local merchant partners, but also as an ongoing connection point to their favorite merchants.
- Expand with acquisitions and business development partnerships. Historically, the core assets Groupon gained from acquisitions were local management teams and small subscriber and merchant partner bases, to which the company then applies its expertise, resources, and brand to scale the business. More recently, Groupon's focus shifted to acquiring businesses with technology and technology talent that could help expand its business. In addition to acquisitions, Groupon entered into agreements with local partners to expand its international presence. Groupon entered into affiliate programs with companies such as eBay, Microsoft, Yahoo, and Zynga, that allowed these partners to display, promote, and distribute Groupon's deals to their users in exchange for a share of the revenue the deals generate.

Corporate Governance

Groupon's Global Code of Conduct and Corporate Governance Guidelines were adopted in the fall of 2011. These documents, and the charters for the Audit, Compensation, and Nominating & Governance Committees, can be found on the company's website at <http://investor.groupon.com/governance.cfm>.

Board of Directors.²⁴ The biographies of the eight members of the Board of Directors are as follows:

Eric Lefkowsky, 42, is a co-founder and the Executive Chairman of Groupon. He is also a founder and director of several firms, including InnerWorkings, Inc., a global provider of managed print and promotional solutions; Echo Global Logistics, Inc., a technology-enabled transportation and logistics outsourcing firm; MediaBank, LLC, a leading provider of integrated media procurement technology; and LightBank, a venture fund focused on helping disruptive technology businesses. Eric serves on the board of directors of Children's Memorial Hospital and the board of trustees of the Steppenwolf Theatre, the Art Institute of Chicago, and the Museum of Contemporary Art. Eric is also an adjunct professor at the University of Chicago Booth School of Business. He holds a bachelor's degree from the University of Michigan and a Juris Doctor from the University of Michigan Law School.

Peter Barris, 59, joined New Enterprise Associates (NEA) in 1992 and has served as Managing General Partner since 1999. Since joining NEA, Peter has led investments in over 20 information technology companies that have completed public offerings or successful mergers. These include such industry pioneering companies as Amisys, CareerBuilder, InnerWorkings, Neutral Tandem, UUNET, and Vonage. Prior to joining NEA, Peter was President and



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Chief Operating Officer of Legent Corporation (LGNT) and Senior Vice President of the Systems Software Division of UCCEL Corporation (UCE). Both companies were ultimately acquired at valuations that were record breaking for their time. Earlier, Peter spent almost a decade at General Electric Company in a variety of management positions, including Vice President and General Manager at GE Information Services. Outside interests include serving on the Northwestern University Board of Trustees and the Dartmouth Tuck School Board of Overseers. Peter previously served on the Executive Committee of the Board of the National Venture Capital Association and was also a founding member of Venture Philanthropy Partners, a philanthropic organization in the Washington, DC, area. He has a BS degree in Electrical Engineering from Northwestern and an MBA from Dartmouth. Mr. Barris is the chair of the Compensation Committee and a member of the Nominating and Governance Committee.

Melody Hobson, 42, is president of Ariel Investments, a Chicago-based money management firm serving institutional clients and individual investors; she also serves as chairman of the board of trustees for Ariel's no-load mutual funds. Beyond her work at Ariel, Melody has become a nationally recognized voice on financial literacy and investor education. Specifically, she is a regular financial contributor on *Good Morning America*, the featured consumer finance expert on Tom Joyner's *Money Mondays* radio program, and a regular columnist for *Black Enterprise*. Melody is a director of three public companies: DreamWorks Animation SKG, Inc., The Estée Lauder Companies Inc., and Starbucks Corporation. In addition, she serves on the boards of various civic organizations including The Field Museum, The Chicago Public Education Fund, and the Sundance Institute. Melody is a graduate of Princeton University where she received her AB degree from the Woodrow Wilson School of Public and International Affairs. She is a member of both the Compensation Committee and the Nominating and Governance Committee.

Brad Keywell, 42, is a founder of MediaBank LLC, Echo Global Logistics, Inc., Groupon Inc., Starbelly, and several other companies. He has served on the Board since Groupon's inception. He is on the Board of the Zell-Lurie Entrepreneurship Institute at the University of Michigan, Big Communications, Warrior Productions, and University of Michigan Hillel Foundation. He was formerly on the Board of Columbia College, as well as the Advisory Committee of the University of Chicago Graduate School of Business Directors' College. Mr. Keywell is a member of the Compensation Committee and the chair of the Nominating and Governance Committee.

Ted Leonsis, 55, is Vice Chairman Emeritus of AOL LLC with more than a decade of experience in global Internet services and media at AOL, where he also served as Vice Chairman and President of several business units. In addition to his work at AOL, Leonsis is the majority owner of the National Hockey League's Washington Capitals and the Women's National Basketball Association's Washington Mystics. He is also the producer of "Nanking," a documentary film that made its premiere at the 2007 Sundance Film Festival. Mr. Leonsis is the chair of the Audit Committee and a member of the Compensation Committee.

Andrew Mason, 31, is a founder of Groupon and has served as its Chief Executive Officer since its inception in November 2008. Prior to co-founding Groupon and ThePoint, Andrew worked as a software developer with Innerworkings, Inc. Andrew received his Bachelor of Arts in Music from Northwestern University.

Daniel Henry, 62, has been the Chief Financial Officer of American Express Company since October 2007. Henry is responsible for leading American Express Company's finance organization and representing American Express to investors, lenders, and rating agencies. He also served as Executive Vice President and Chief Financial Officer of U.S. Consumer, Small Business and Merchant Services and joined American Express as Comptroller in 1990. Prior to joining American Express, Henry was a partner with Ernst & Young. Mr. Henry is a member of the Audit Committee.

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Robert Bass, 62, served as a Vice Chairman of Deloitte LLP from 2006 through June 2012, and was a partner in Deloitte from 1982 through June 2012. Mr. Bass specializes in e-commerce, mergers and acquisitions, and SEC filings. At Deloitte, Mr. Bass was responsible for all services provided to Forstmann Little and its portfolio companies and is the advisory partner for Blackstone, DIRECTV, McKesson, IMG, and CSC. He has also previously been the advisory partner for priceline.com, RR Donnelley, Automatic Data Processing, Community Health Systems, and Avis Budget. He is a member of the American Institute of Certified Public Accountants and the New York and Connecticut State Societies of Certified Public Accountants. Mr. Bass is a member of the Audit Committee.

Daniel Henry and Robert Bass joined the Board on April 26 and June 19, 2012, respectively, in a move to bring more accounting and financial expertise to the Board. Mr. Henry replaced Howard Schultz, CEO of Starbucks. Mr. Bass replaced Kevin Efrusy, a partner at the venture-capital firm Accel Partners.²⁵

Top Management.²⁶ The biographical sketches for Groupon's top management team are as follows:

Andrew D. Mason, 31, is a co-founder of Groupon and has served as its Chief Executive Officer and a director since its inception. In 2007, Mr. Mason co-founded ThePoint, a Web platform that enables users to promote collective action to support social, educational, and civic causes, from which Groupon evolved. Prior to co-founding ThePoint, Mr. Mason worked as a computer programmer with InnerWorkings, Inc. Mr. Mason received his Bachelor of Arts from Northwestern University. Mr. Mason brings to the Board the perspective and experience as one of Groupon's founders and as Chief Executive Officer. Mr. Mason was elected to the Board pursuant to voting rights granted to the former holders of Groupon's common stock and preferred stock under Groupon's voting agreement, which terminated as a result of the company's initial public offering.

Jason E. Child, 43, has served as Chief Financial Officer since December 2010. From March 1999 through December 2010, Mr. Child held several positions with Amazon.com, Inc., including Vice President of Finance, International from April 2007 to December 2010, Vice President of Finance, Asia from July 2006 to July 2007, Director of Finance, Amazon Germany from April 2004 to July 2006, Director of Investor Relations from April 2003 to April 2004, Director of Finance, Worldwide Application Software from November 2001 to April 2003, Director of Finance, Marketing and Business Development from November 2000 to November 2001, and Global Controller from October 1999 to November 2000. Prior to joining Amazon.com, Mr. Child spent more than seven years as a C.P.A. and a consulting manager at Arthur Andersen. Mr. Child received his Bachelor of Arts from the Foster School of Business at the University of Washington.

Joseph M. Del Preto II, 36, has served as Chief Accounting Officer since April 2011. From January 2011 to April 2011, Mr. Del Preto served as Groupon's Global Controller. Prior to joining Groupon, Mr. Del Preto served as Controller and Vice President, Finance of Echo Global Logistics, Inc. from April 2009 to December 2010. From January 2006 to March 2009, Mr. Del Preto served as Controller of InnerWorkings, Inc. Mr. Del Preto began his career at PricewaterhouseCoopers LLP. Mr. Del Preto received his Bachelor of Science degree from Indiana University.

Jason D. Harinstein, 36, has served as Senior Vice President-Corporate Development since March 2011. From June 2005 to February 2011, Mr. Harinstein served in several capacities at Google, Inc., including most recently as Director of Corporate Development. From July 2003 to June 2005, Mr. Harinstein worked as an Equity Research Associate at Deutsche Bank Securities, Inc. where he covered Internet advertising, online

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search, eCommerce and video game companies. Previously, Mr. Harinstein served as a strategy consultant at iXL, Inc. (now part of Razorfish) from June 1999 to June 2001, and at Andersen Consulting Strategic Services (now Accenture) from September 1997 to June 1999. Mr. Harinstein received his Bachelor of Arts in Economics from Northwestern University and his Master's in Business Administration from the University of Chicago.

Jeffrey Holden, 43, has served as Senior Vice President-Product Management since April 2011. In 2006, Mr. Holden co-founded Pelago, Inc. and served as its Chief Executive Officer until Groupon acquired Pelago in April 2011. Prior to co-founding Pelago, Mr. Holden held several positions at Amazon.com, Inc., including Senior Vice President, Worldwide Discovery, from March 2005 to January 2006, Senior Vice President, Consumer Applications, from April 2004 to March 2005, Vice President, Consumer Applications, from April 2002 to April 2004, and Director, Automated Merchandising and Discovery from February 2000 to April 2002. Mr. Holden joined Amazon.com in May 1997 as Director, Supply Chain Optimization Systems. Mr. Holden received his Bachelor of Science and Master of Science degrees in Computer Science from the University of Illinois at Urbana-Champaign.

David R. Schellhase, 48, has served as General Counsel since June 2011. From March 2010 to May 2011, Mr. Schellhase served as Executive Vice President, Legal of salesforce.com, inc. From December 2004 to March 2010, Mr. Schellhase served as the Senior Vice President and General Counsel of salesforce.com, and he served as Vice President and General Counsel of salesforce.com from July 2002 to December 2004. From December 2000 to June 2002, Mr. Schellhase was an independent legal consultant and authored a treatise entitled Corporate Law Department Handbook. Previously, he served as General Counsel at Linuxcare, Inc., The Vantive Corporation and Premenos Technology Corp. Mr. Schellhase received a Bachelor of Arts from Columbia University and a Juris Doctor from Cornell University.

Brian J. Schipper, 51, has served as Senior Vice President-Human Resources since June 2011. From October 2006 to May 2011, Mr. Schipper served as Senior Vice President and Chief Human Resources Officer of Cisco Systems, Inc. From November 2003 to October 2006, Mr. Schipper served as the Corporate Vice President, Human Resources of Microsoft Corporation. From February 2002 to March 2003, Mr. Schipper was Partner and Head of Human Resources and Administration for Andor Capital Management LLC. From March 2000 to February 2002, Mr. Schipper served as Senior Vice President of Human Resources and Administration at DoubleClick, Inc. Prior to joining DoubleClick, Mr. Schipper served as Vice President, Human Resources at PepsiCo, Inc. from May 1995 to March 2000. Prior to joining PepsiCo, Mr. Schipper worked at Compaq Computer Corporation, where he was global head of compensation and benefits and head of Human Resources for North America. Mr. Schipper received his Bachelor's from Hope College and his Master's in Business Administration from Michigan State University.

Brian K. Totty, 45, Ph.D., has served as Senior Vice President—Engineering and Operations since November 2010. Dr. Totty was the Chief Executive Officer of Ludic Labs, Inc., a startup venture developing a new class of software applications from January 2006 through November 2007. We acquired Ludic Labs in November 2010. Dr. Totty also was a co-founder and Senior Vice President of Research and Development of Inktomi Corporation from February 1996 to August 2002. Dr. Totty received his Ph.D. in computer science from the University of Illinois at Urbana-Champaign, his Master of Public Administration from Harvard's Kennedy School and his Bachelor of Science from the Massachusetts Institute of Technology.



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Operations

Groupon's operations were divided into North America (United States and Canada) and International segments.

EXHIBIT 1

Year Ended December 31						
	2009	% of total	2010	% of total	2011	% of total
(dollars in thousands)						
North America	\$ 14,540	100.0%	\$ 200,412	64.0%	\$ 634,980	39.4%
International	—	—	112,529	36.0%	975,450	60.6%
Revenue	\$ 14,540	100.0%	\$ 312,941	100.0%	\$ 1,610,430	100.0%

SOURCE: Groupon, Inc. 10-K (March 30, 2012), p. 45.

One trend that contributed to Groupon's growth was its investment in international markets. In 2009, the company's operations focused entirely on North America. In 2010, however, Groupon began looking abroad for growth, targeting key markets in both Europe and Asia. As a result, the International segment accounted for 36% of total revenues in 2010. As Groupon continued to see growth in 2011, the segment accounted for 60.6%, as shown in Exhibit 1. While this rapid expansion of the International segment contributed substantially to the company's growth, it also contributed to its annual net losses. In fact, management blamed the net loss in 2011 primarily on the "rapid expansion of [its] International segment during the year, which involved investing heavily in upfront marketing, sales and infrastructure related to the build out of [its] operations" in early stage countries.²⁷ Groupon's international segment often felt the impact of unfavorable foreign exchange rates.

To accompany this expansion, Groupon made changes to its distribution of resources, including corporate facilities and employees. The company's principal executive properties are described in Exhibit 2. Other facilities were located throughout the world.

The size and geographic distribution of Groupon's sales force over time is shown in Exhibit 3. Considering Groupon's two-pronged dependence on subscribers and on merchants, many of whom were very small businesses, the company maintained high-touch relationships with its merchants. In addition to its sales team, Groupon employed customer service representatives, editorial staff, marketing planners, merchant research and services teams, and "city planners" who created the schedules for each Groupon city every week.²⁸

The growth in Groupon's sales force reflected international operations that began in May 2010 with the acquisition of CityDeal Europe GmbH. CityDeal was founded by Oliver Samwer and Marc Samwer, who have served since the acquisition as consultants and been extensively involved in the development and operations of Groupon's international segment.²⁹

EXHIBIT 2

Description of Use	Square Footage	Operating Segment	Location	Lease Expiration
Corporate office facilities	550,000	North America	Chicago, IL	From 2012 through 2018
Corporate office facilities	30,000	International	Berlin, Germany; Schaffhausen, Switzerland	From 2012 through 2022

SOURCE: Groupon, Inc. 10-K (March 30, 2012), p. 33.





EXHIBIT 3

Size of sales force	Mar. 31, 2010	June 30, 2010	Sept. 30, 2010	Dec. 31, 2010	Mar. 31, 2011	June 30, 2011	Sept. 30, 2011	Dec. 31, 2011
North America	128	201	348	493	661	990	1,004	1,062
International	—	1,080	1,224	2,080	2,895	3,860	3,849	4,134
Total	128	1,291	1,572	2,573	3,556	4,850	4,853	5,196

SOURCE: Groupon, Inc. 10-K (March 30, 2012), p. 8.

Agreements under which Oliver and Marc Samwer provided consulting services were set to expire in October 2012 and October 2013, respectively.³⁰

In January 2011, Groupon B.V., a subsidiary, entered into a joint venture along with Rocket Asia GmbH & Co. KG, an entity controlled by the Samwers.³¹ Groupon B.V. became part owner of GaoPeng.com, which operates a group buying site offering discounts for products and services to individual consumers and businesses via Internet websites and social and interactive media.³² GaoPeng.com began offering daily deals in Beijing and Shanghai in March 2011 and subsequently began offering daily deals in other major cities in China.³³

Such acquisitions and joint ventures were an important part of Groupon's growth strategy. Groupon acquired eight firms in 2010, another nine in 2011, and an additional eight firms as of May 2012.³⁴

Finance

Exhibits 4 and 5 show Groupon's consolidated statement of operations and consolidated balance sheet for the fiscal years ended 2008 through 2011.

For the years ended 2009, 2010, and 2011, Groupon reported revenue of US\$14.5 million, US\$312.9 million, and US\$1.6 billion, respectively.³⁵ This represented an annual compound growth rate of 380%. From 2010 to 2011 specifically, revenue increased by US\$1.3 billion. The company attributed this growth mainly to expanding the scale of its business both domestically and internationally through acquisitions, as well as by entering new markets. Initiatives that contributed to this expansion included an increase in marketing expenditures, as well as an increase in the company's sales force.³⁶

Despite such significant revenue growth, operating income remained negative in 2011 (see Exhibit 4). Total operating expenses reached over US\$1.8 billion in fiscal year 2011, an increase of 151.4% from that of 2010. Groupon attributed this rise to an increase of US\$216 million in the cost of revenue due to increases in credit card processing fees, refunds, and editorial salary costs. Higher volumes of merchant partner transactions and a larger subscriber base contributed to these costs.³⁷

The company's greatest increases in operating expenses, however, were in marketing, selling, general, and administrative expenses. For the years ended December 31, 2009, 2010, and 2011, the company reported marketing expenses of US\$5.1 million, US\$290.6 million, and US\$768.5 million, respectively.³⁸ In its annual report, Groupon made it clear that such increases in marketing expenses have been necessary, stating that "Since our inception, we have prioritized growth, and investments in our marketing initiatives have contributed to our losses."³⁹ Management viewed investments in marketing as a necessary cost to acquire subscribers. When compared to the profits generated from these subscribers over time, the cost to maintain a subscriber was relatively expensive, as interaction was largely limited to e-mails and mobile applications. As its business continued to grow and became established in more markets, Groupon expected that its marketing expense would decrease as a percentage of revenue.



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EXHIBIT 4

Groupon, Inc. Consolidated Statement of Operations (In thousands, except share and per-share amounts)

	Year Ended December 31			
	2008	2009	2010	2011
	(dollars in thousands, except share data)			
Consolidated Statements of Operations Data:				
Revenue (gross billings of \$94, \$34,082, \$745,348 and \$3,985,501, respectively)	\$ 5	\$ 14,540	\$ 312,941	\$ 1,610,430
Costs and expenses:				
Cost of revenue	88	4,716	42,896	258,879
Marketing	163	5,053	290,569	768,472
Selling, general, and administrative	1,386	5,848	196,637	821,002
Acquisition-related	—	—	203,183	(4,537)
Total operating expenses	1,637	15,617	733,285	1,843,816
Loss from operations	(1,632)	(1,077)	(420,344)	(233,386)
Interest and other income (expense), net	90	(16)	284	5,973
Equity-method investment activity, net of tax	—	—	—	(26,652)
Loss before provision for income taxes	(1,542)	(1,093)	(420,060)	(254,065)
Provision (benefit) for income taxes	—	248	(6,674)	43,697
Net loss	(1,542)	(1,341)	(413,386)	(297,762)
Less: Net loss attributable to non-controlling interests	—	—	23,746	18,335
Net loss attributable to Groupon, Inc.	(1,542)	(1,341)	(389,640)	(279,427)
Dividends on preferred shares	(277)	(5,575)	(1,362)	—
Redemption of preferred stock in excess of carrying value	—	—	(52,893)	(34,327)
Adjustment of redeemable non-controlling interests to redemption value	—	—	(12,425)	(59,740)
Preferred stock distributions	(339)	—	—	—
Net loss attributable to common stockholders	\$ (2,158)	\$ (6,916)	\$ (456,320)	\$ (373,494)
Net loss per share of common stock				
Basic	\$ (0.01)	\$ (0.04)	\$ (2.66)	\$ (1.03)
Diluted	\$ (0.01)	\$ (0.04)	\$ (2.66)	\$ (1.03)
Weighted average number of shares outstanding				
Basic	333,476,258	337,208,284	342,698,772	362,261,324
Diluted	333,476,258	337,208,284	342,698,772	362,261,324

SOURCE: Groupon, Inc. 10-K (March 30, 2012), p. 38.

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EXHIBIT 5

Groupon, Inc. Consolidated Balance Sheets (in thousands, except share and per-share amounts)

	December 31	
	2010	2011
Assets		
Current assets:		
Cash and cash equivalents	\$ 118,833	\$ 1,122,935
Accounts receivable, net	42,407	108,747
Prepaid expenses and other current assets	12,615	91,645
Total current assets	173,855	1,323,327
Property and equipment, net	16,490	51,800
Goodwill	132,038	166,903
Intangible assets, net	40,775	45,667
Investments in equity interests	—	50,604
Deferred income taxes, non-current	14,544	46,104
Other non-current assets	3,868	90,071
Total assets	\$ 381,570	\$ 1,774,476
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 57,543	\$ 40,918
Accrued merchant payable	162,409	520,723
Accrued expenses	98,323	212,007
Due to related parties	13,321	246
Deferred income taxes, current	17,210	76,841
Other current liabilities	21,613	144,427
Total current liabilities	370,419	995,162
Deferred income taxes, non-current	604	7,428
Other non-current liabilities	1,017	70,766
Total liabilities	372,040	1,073,356
Commitments and contingencies (see Note 8)		
Redeemable noncontrolling interests	2,983	1,653
Groupon, Inc. Stockholders' Equity		
Series D, convertible preferred stock, \$.0001 par value, 6,560,174 shares authorized and issued, 6,258,297 shares outstanding at December 31, 2010, and no shares outstanding at December 31, 2011	1	—
Series F, convertible preferred stock, \$.0001 par value, 4,202,658 shares authorized, issued, and outstanding at December 31, 2010, and no shares outstanding December 31, 2011	1	—
Series G, convertible preferred stock, \$.0001 par value, 30,075,690 shares authorized, 14,245,018 shares issued and outstanding at December 31, 2010 and no shares outstanding at December 31, 2011, liquidation preference of \$450,000 at December 31, 2010	1	—

(continued)
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EXHIBIT 5
(Continued)

	December 31	
	2010	2011
Voting common stock, \$0.001 par value, 1,000,000,000 shares authorized, 422,991,996 shares issued and 331,232,520 shares outstanding at December 31, 2010 and no shares outstanding at December 31, 2011	4	—
Class A common stock, par value \$0.0001 per share, no shares authorized, issued, and outstanding at December 31, 2010; 2,000,000,000 shares authorized, 641,745,225 shares issued and outstanding at December 31, 2011	—	64
Treasury stock, at cost, 93,328,656 shares at December 31, 2010 and no shares outstanding at December 31, 2011	(503,173)	—
Additional paid-in capital	921,122	1,388,253
Stockholder receivable	(286)	—
Accumulated deficit	(419,468)	(698,704)
Accumulated other comprehensive income	9,875	12,928
Total Groupon, Inc. Stockholders' Equity	8,077	702,541
Noncontrolling interests	(1,530)	(3,074)
Total equity	6,547	699,467
Total liabilities and equity	\$ 381,570	\$ 1,774,476

SOURCE: Groupon, Inc. 10-K (March 30, 2012), p. 65.

Selling expenses reported in Exhibit 4 consisted of "payroll and sales commissions for sales representatives, as well as costs associated with supporting the sales function such as technology, telecommunications, and travel."⁴⁰ For the years 2009, 2010, and 2011, total selling, general, and administrative expenses were reported at US\$5.8 million, US\$196.6 million, and US\$821.0 million, respectively.⁴¹ Groupon attributed these increases largely to the expansion of its global sales force as well as investments in technology and corporate infrastructure.⁴² Like its marketing expense, Groupon expected that selling, general, and administrative expenses would decrease as a percentage of revenue as its operations matured over time.

The underlying concern regarding Groupon's financials was that the company realized a total net loss in income every year since its inception. For the years 2008 through 2011, these losses amounted to US\$1.5 million, US\$1.3 million, US\$413.3 million, and US\$297.7 million, respectively.⁴³ As shown in the statement of retained earnings in Exhibit 6, these losses led to an accumulated deficit of US\$698.7 million in 2011. In this light, management decided not to pay dividends, intending instead "to retain all of our earnings for the foreseeable future to finance the operation and expansion of our business."⁴⁴

EXHIBIT 6

Consolidated Statement of Retained Earnings (thousands)

Report Date	12/31/2011	12/31/2010	12/31/2009	12/31/2008
Previous retained earnings (accumulated deficit)	(419,468)	(29,828)	(2,574)	(1,032)
Common stock dividends	—	—	20,338	—
Preferred stock dividends	—	—	5,575	—
Forfeiture of dividends	(191)	—	—	—
Retained earnings (accumulated deficit)	(698,704)	(419,468)	(29,828)	(2,574)

SOURCE: Mergent Online.

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In 2012, Groupon continued to see exceptional growth in revenues. Exhibit 7 compares the results of operations from the quarter ended March 31, 2012 to the quarter ended March 31, 2011. For the first quarter of 2012, the company reported revenues of US\$559.3 million, compared to US\$295.5 million for the first quarter of 2011.⁴⁵ Total operating expenses continue to rise in 2012, increasing by US\$106.9 million from the first quarter of 2011, reflecting significant increases in cost of revenue and selling expenses. Groupon made strides toward cutting marketing spending in 2012, reporting US\$116.6 million in marketing expenses compared to US\$230.1 million in the first quarter of 2011. The company attributed this expense cut to a strengthening brand name that allowed it to become more established in markets around the globe. As of March 31, 2012, Groupon reported 36.8 million active customers, more than double the 15.3 million reported on March 31, 2011.⁴⁶ The amount of revenue that Groupon received per customer had not increased, however; revenue per average active customer was

EXHIBIT 7
Groupon, Inc.
Condensed Consolidated Statements of Operations
(In thousands, except share and per-share amounts) (unaudited)

Three Months Ended March 31		
	2011	2012
(Restated)		
Revenue (gross billings of \$668,174 and \$1,354,800, respectively)	\$ 295,523	\$ 559,283
Costs and expenses:		
Cost of revenue	39,765	119,498
Marketing	230,085	116,615
Selling, general, and administrative	142,821	283,583
Acquisition-related	—	(52)
Total operating expenses	412,671	519,644
(Loss) income from operations	(117,148)	39,639
Interest and other income (expense), net	1,060	(3,539)
Equity-method investment activity, net of tax	(882)	(5,128)
(Loss) income before provision for income taxes	(116,970)	30,972
Provision (benefit) for income taxes	(3,079)	34,565
Net loss:	(113,891)	(3,593)
Less: Net loss (income) attributable to noncontrolling interests	11,223	(880)
Net loss attributable to Groupon, Inc.	(102,668)	(4,473)
Redemption of preferred stock in excess of carrying value	(34,327)	—
Adjustment of redeemable noncontrolling interests to redemption value	(9,485)	(7,222)
Net loss attributable to common stockholders	\$ (146,480)	\$ (11,695)
Net loss per share:		
Basic	\$ (0.48)	\$ (0.02)
Diluted	\$ (0.48)	\$ (0.02)
Weighted average number of shares outstanding:		
Basic	307,849,412	644,097,375
Diluted	307,849,412	644,097,375

SOURCE: Groupon, Inc. 10-Q (May, 15, 2012), p. 5.

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Groupon, Inc.

reported at US\$72.41 on March 31, 2011, compared to US\$71.77 on March 31, 2012.⁴⁷ Rather than adding revenue solely by acquiring more customers, Groupon was searching for ways to increase the amount of revenue it received per subscriber from its existing base.

"We Don't Measure Ourselves in Conventional Ways"

Investors and the Securities and Exchange Commission began to question management's reporting of Groupon's financials. Although Groupon disclosed all financial data required by the SEC, management stressed the importance of other, more unconventional metrics. The company, which said that it did not "measure [itself] in conventional ways," placed more importance on metrics such as adjusted consolidated segment operating income, free cash flow, and gross billings, rather than net income.⁴⁸ Groupon reported net losses in each of the past three years and believed that unique metrics better reflected its financial progress.

Groupon defined adjusted consolidated segment operating income (CSOI) as "the consolidated segment operating income before new subscriber acquisition costs and certain non-cash charges."⁴⁹ It believed that adjusted CSOI was an important measure of the performance of its business since adjusted CSOI excluded expenses that management believed were not indicative of future operating expenses. Free cash flow was defined as cash flow from operations reduced by "purchases of property and equipment"⁵⁰ and although the measure could be revealing, Groupon acknowledged that it was a non-GAAP financial measure. Gross billings, another proprietary metric, was the gross amount collected from customers for Groupons sold. Management viewed gross billings as a measurement of growth, but its use in revenue recognition was a source of controversy. Wall Street observers argued that Groupon's use of these non-GAAP measures was simply a strategy to portray its financials favorably in light of its lack of profitability.⁵¹

In 2011, Groupon had to restate its earnings for the three months ended March 31, 2011 "to correct for an error in its presentation of revenue."⁵² Groupon historically reported its revenue as the gross amounts billed to its subscribers. The revision required revenue to be restated as the net of the amounts related to merchant fees. This error prompted the company to report a "material weakness" in its internal control over financial reporting.⁵³ The Condensed Statement of Operations shown in Exhibit 8 for the three months ended March 31, 2011, was restated to show the net amount the company retained after paying merchant fees. Several other income statement expenses were changed as well to align with the reporting of revenue on a net basis.

Then, on March 30, 2012, the company announced that it would also have to restate earnings for the fourth quarter of 2011 after a higher-than-expected number of customers demanded refunds.⁵⁴ Going forward, management planned to improve its internal controls for financial reporting. With significant errors and multiple financial restatements present in

EXHIBIT 8
Groupon, Inc. Notes
to Condensed
Consolidated
Financial State-
ments for the
Three Months
Ended March 31,
2011, in Thousands
(Unaudited)

	As previously reported (unaudited)	Restatement adjustment	As restated
Revenue	\$ 644,728	(349,205)	\$ 295,523
Cost of revenue	\$ 374,728	(334,963)	\$ 39,765
Marketing	\$ 208,209	21,876	\$ 230,085
Selling, general, and administrative	\$ 178,939	(36,118)	\$ 142,821

SOURCE: Groupon, Inc. 10-Q (May 15, 2012), p. 11.



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Groupon's first year as a publicly traded company, investors continued to question the company's disclosure methods and the reliability of its internal reports. Five federal class action securities complaints, and six federal and two state stockholder derivative lawsuits had been brought against Groupon and its current and former directors and officers since the restatement.⁵⁵ The addition of new members of the Board of Directors with accounting and financial expertise was considered necessary to regain investor confidence.⁵⁶

Information Technology

Groupon did not equivocate regarding technology's importance to its operations and business strategy:

We employ technology to improve the experience we offer subscribers and merchant partners, increase the rate at which our customers purchase Groupons, and enhance the efficiency of our business operations. A component of our strategy is to continue developing and refining our technology.⁵⁷

Almost all of the company's communication with both customers and merchant partners was electronic. It was important for Groupon to adopt an information system that would facilitate efficient communication with both merchants and customers. Groupon used a common information technology platform that enhanced communication while also providing management and merchant partners the ability to track deal performance and analytics for demographic data and capacity. The platform included business operations tools to track internal workflow; applications and infrastructure to serve content at scale; dashboards and reporting tools to display operating and financial metrics for historical and ongoing deals; and a publishing and purchasing system for consumers.⁵⁸ Groupon used the platform only in North American operations in 2012, but management planned to merge the system with the company's more segmented international information technology platforms. While there was no timetable in place for this move, Groupon reported that it planned to "enable greater efficiencies and consistency across [its] global organization."⁵⁹

Information system platforms, as well as websites, applications, and back-end business intelligence systems were hosted at data centers in Florida, Texas, California, and overseas in Asia and Europe. For security purposes, Groupon used commercial antivirus, firewall, and patch-management technologies to protect and maintain systems located at the data centers. To ensure the security of its website as well as customer transactions, Groupon also invested in intrusion and pattern detection tools, as well as Secure Socket Layer (SSL) to provide encryption for transferring data. These security measures were easily scalable to accommodate increasing numbers of subscribers.⁶⁰

Marketing

Since the company's founding, marketing had been at the core of Groupon's business strategy. Management's aggressive marketing efforts fueled revenue approaching US\$2 billion in three years of existence. A first mover in the daily deal industry, Groupon owned number-one market share in 37 of 48 countries served as of the first quarter of 2012.⁶¹ Specifically in North America, Groupon held 53% market share, as of the second quarter of 2012.⁶²

Critical to Groupon's strategy was growing its subscriber and customer base. As stated earlier, the vast majority of its investments to fuel this growth were through online marketing initiatives: search engine marketing, display advertisements, referral programs, and affiliate marketing.⁶³ Groupon also marketed to merchant partners to grow the number and variety of deals it could offer customers. To further increase merchant partner growth, Groupon utilized

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a sales force of over 5000 inside and outside representatives. The sales force was responsible for building partner relationships as well as providing local expertise.

The company focused the majority of its marketing efforts on demographics most likely to use a Groupon: relatively young consumers more prone to search for discounts when shopping and most likely to use the Internet or mobile applications to do so. According to Morpace Inc., the majority of Groupon's customers (40.2%) were between the ages of 18 and 34,⁶⁴ and although women were historically more likely to purchase online coupons, men and women had been found almost equally likely to use Groupon deals. As with all coupon users, Groupon users had higher income.⁶⁵

Groupon's attempt to participate in national television ads during the 2011 Super Bowl was widely criticized. A series of ads meant to "spoof" typical celebrity-endorsed public service announcements fell flat and many found the ads offensive.⁶⁶ Groupon dropped the ads and ultimately stopped working with the advertising agency that created the spots.⁶⁷

Groupon's investments in marketing were substantial. Marketing expenses were largely variable, increasing significantly as revenues grew. For the years ended 2008 through 2011, marketing expenses were reported at US\$163 thousand, US\$5.05 million, US\$290.57 million, and US\$768.47 million, respectively (see Exhibit 4).

Distribution. The distribution of Groupon's deals relied heavily on technology. Deals were distributed to customers directly through daily e-mails, websites, and mobile applications, as well as through social networks. In an effort to reach more potential customers, Groupon also utilized various online affiliates to display and promote deals on their websites. The company's "online affiliates" included eBay, Microsoft, Yahoo, and Zynga.⁶⁸ Partnerships allowed for the distribution of daily deals to not only Groupon's customer base, but also to the affiliate's user base. Groupon also partnered with thousands of smaller online affiliates that could embed a Groupon widget on their websites and earn a commission whenever their site's visitors purchased Groupons through the link.⁶⁹ Management believed that leveraging affiliate relationships online in this manner would extend the distribution of Groupon deals to a larger customer base.

In an effort to attract more customers and to ease communication with existing customers, Groupon launched a mobile application in March 2010. Deals were offered at no additional cost on the iPhone, Android, BlackBerry, and Windows mobile operating systems. The applications allowed consumers to "browse, purchase, manage and redeem deals on their mobile devices as well as access Groupon Now! Deals that were offered based on the location of the mobile user."⁷⁰ In this way, the mobile applications promoted immediate deals based on the customer's desire and location. As of December 31, 2011, the Groupon App had been downloaded over 26 million times.⁷¹

Groupon began targeting online social networks as another possible distribution channel. Daily deals were published through various social networks, while website and mobile application interfaces also allowed consumers to push notifications of deals to their personal social network. Groupon acknowledged that social networks were not yet a "material portion of customer acquisition."⁷²

Products. Founded strictly as a daily deals service, Groupon historically did not offer much variety in terms of deal categories. As its operations grew, however, Groupon made an effort to transition "from offering deals only through email to having a local commerce marketplace where customers can purchase Groupons for a variety of services and products from local, national and online merchants."⁷³ In 2012, Groupon offered the following types of deals:⁷⁴

- **Featured Daily Deals** were distributed by targeting technology to current and potential customers based on location and personal preferences. Daily deals were sent to



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subscribers through mass e-mails and posted on the website and mobile application. This product was launched in October 2008 and was offered in all North American and International markets.

- Groupon's primary focus was on local deals, but the company also offered *National Deals* from national merchants to build brand awareness and acquire new customers in the North American market. It featured deals from over 100 national merchant partners, including Domino's Pizza, Sony Electronics, and The Body Shop.
- *Groupon Now!* deals were initiated by a merchant on demand and offered instantly to customers through mobile devices and the Groupon website. These deals targeted current and potential customers within close proximity of the merchant, and the purchased Groupons typically expired within a few hours of the deal launch. This product was launched in the second quarter of 2011.
- *Groupon Goods* enabled customers to purchase vouchers for products directly from the website or mobile application. Deals were offered for a variety of product categories, including electronics, home and garden, and toys. This product was launched in September 2011 in select North American and International markets.
- *Groupon Getaways* are travel deals that feature domestic and international hotels, airfare, and package deals. Groupon Getaways was launched in July 2011.
- *GrouponLive* is a partnership with LiveNation whereby Groupon serves as a local resource for LiveNation events and clients of its global ticketing business, Ticketmaster. GrouponLive is offered as part of the featured daily deals and was launched in May 2011.
- *Groupon Rewards*, a free service to merchant partners that allowed customers to earn reward points through repeat visits that could be used to unlock special deals, were launched in October 2011.

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Competition

Groupon rose to prominence in uncertain economic conditions—during the Great Recession and its slow recovery. Consumers began spending less as a result of the financial crisis, and so the demand for coupons increased. At the same time, merchants began looking for new and effective ways of attracting business. This combination could explain why Groupon might owe some of its unprecedented growth to the economic environment into which it was born, but it also explained the more recent blitz of competition Groupon has faced.

Andrew Mason's idea to apply the tipping point principle to online commerce and facilitate the leveraging of consumers' collective power was innovative and established Groupon as a first mover in the daily deals segment. The ease with which the business model could be replicated, however—in concert with the strong demand for discounts—ensured that Groupon would not be the only company competing for market share.

Groupon's competition was fairly broad; the company competed with traditional offline coupon and discount services, as well as newspapers, magazines, and other traditional media companies that provided coupons and discounts on products and services.⁷⁵ The most intense competition was with companies utilizing the online daily deals business model—to whatever extent and with whatever focus. Some such competitors offered deals as an add-on to their core business, while others adopted a business model similar to Groupon's.⁷⁶ These included GiltCity, DailyDeals.com, Bloomspot, and Eversave. Competition also existed in more narrowly positioned companies that offered services more focused on particular merchant categories or markets. They included Daily Pride, for the Lesbian, Gay, Bisexual, and Transgendered community; Jewpon, for the Jewish community; My Pet Savings, for pet owners; and Group-Price, for online businesses, among others.

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to grow, and promising new products were being pilot tested in specific markets. The company's prospects looked brighter in 2012 than in years past, but it had yet to record a profit. The question remained whether or not Andrew Mason's Groupon could do so in the future.

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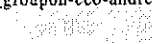
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