CASE 11

Groupon, Inc.

DAILY DEAL OR LASTING SUCCESS?

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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.

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 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.

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.

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.

- **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 Lefkofsky, 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

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.

Mellody 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, Mellody 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*. Mellody 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. Mellody 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.

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