Daily deal promotions beneficial for certain kinds of startups: study

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In the first-of-its-kind analysis of Groupon's impact on a startup company, a new Rice University study found that the daily deal promotion was beneficial even though it had no material impact on the company's profits when unredeemed Groupons were not accounted for. When those unredeemed Groupons were factored in, the company had a substantial 30 percent increase in profits.

Having run the Groupon promotion, the company – Houston-based startup Gourmet Prep Meals (GPM) – had greater exposure and earned revenues almost 140 percent higher than it would have earned had it not run the promotion, according to the study. That increased exposure also led full-price-paying customers to more than triple their rates of purchase.

"Daily deal promotions can be effective marketing tools for retail startup businesses in local markets to achieve exposure and stimulate sales," said Utpal Dholakia, associate professor of management at Rice's Jones Graduate School of Business and lead author of the study. "But you can't take a one-size-fits-all approach and assume a daily deal promotion will work for any business. It worked here because the company was a startup, relatively unknown to its target customer base, with owners who used the promotion as a market-research opportunity and focused on providing a high-quality product and service throughout."

Dholakia and Gur Tsabar, a co-founder of GPM and co-author of the study, analyzed the customer data from the company's launch July 15, 2010, through April 14, 2011. The company ran its Groupon promotion -- $25 worth of ready-to-cook meals for $12 – Sept. 30 and sold more than 600 Groupons to be redeemed by March 31. GPM intentionally did not undertake any other major advertising or branding initiatives.

The data show that during the first 2 1/2 months that GPM was in business, its revenues and profits increased at a modest rate. However, as soon as the Groupon redemptions started, its revenues more than doubled. Profits increased at a modest rate. However, both revenues and profits spiked at the end of the redemption period when GPM recognized the earnings from the unredeemed Groupons, which totaled more than 30 percent of those sold.

Profit margins before the Groupon promotion were inconsistent but substantial. As expected, right after the Groupon promotion began, the profit per transaction dipped significantly and then stabilized at a level that was more than 60 percent lower than the average profit per transaction earned before the promotion began.

"Groupon users bring in less than half the revenues of GPM's full-price-paying customers, and the company loses a small amount of money on its average Groupon transaction," Dholakia said. "But about 20 percent of those transactions yielded relatively high profits and helped keep GPM's profit margin above zero throughout."

Dholakia said that the Groupon promotion's exposure also sustained the profits by accelerating the purchase rate of full-price-paying customers.

The study, "A Startup's Experience With Running a Groupon Promotion," is also the first to publicly show and describe the redemption pattern of Groupons over the course of the entire promotional period for one particular firm.

Dholakia compared average redemption rates. The first spike (at the beginning of the promotion) had a redemption mode about 3.5 times the rate observed during the middle weeks. The second spike (at the end of the promotion) was almost five times higher than that baseline.

The new study also offers a glimpse at whether daily deal promotions create repeat customers. Approximately 4 percent of GPM's Groupon users returned for at least a second purchase, and when they did, they spent more than what full-price-paying customers spent on average. Dholakia said it appears to be a promising start, but he and Tsabar will continue to track it over the coming weeks and months.

More information: The complete study can be found at www.ruf.rice.edu/~dholakia/

Provided by Rice University

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