Deal sites appeal shoppers and businesses alike

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In this April 29, 2011 photo, Leslie Hall, left, works inside an office as and Kelly Bigel, 22, right, and other members of the merchant services department of LivingSocial work in a hallway at LivingSocial's offices in Washington. (AP Photo/Jacquelyn Martin)

Groupon is adding 150 employees a month at its U.S. headquarters and trains them in a church because the conference rooms at its headquarters aren't big enough. Ideeli has crammed so much electronic equipment into its New York office that the power goes out every day.

And at LivingSocial, well, the living is a little too social. Its third office in Washington, open just two months, ran out of room so fast that employees have to work at narrow desks in the hallway.

Deal-a-day websites blast email offers for deep discounts, sometimes good for only a few hours. And they're becoming so popular that their offices are starting to look as crowded as their subscribers' inboxes.

In just three years, the business model has changed local advertising, delivering faster results than other marketing methods. Store owners get immediate revenue and can see exactly how many customers an offer brings in.

The exponential growth of the sites, along with the emergence of hundreds of clones, is reminiscent of tech companies before the dot-com stock bubble burst in 2000. But Lou Kerner, a social media analyst at Wedbush, argues this isn't a fad: It's a new category of commerce that has changed how companies from hair salons to sandwich shops market their products.

Groupon, the No. 1 daily-deal site, has swelled from 2 million subscribers to 85 million over the past year and a half, while second-place LivingSocial went from 120,000 subscribers to 28 million.

The sites are expected to generate $2.7 billion in revenue this year, more than doubling from last year, according to Local Offer Network, which collects and distributes deals from hundreds of sites. The daily-deal market could reach $4 billion by 2015, says Mark Fratrik, vice president at marketing research firm BIA/Kelsey. While that's a small slice of the $142 billion in online retail sales, daily-deal revenue is growing much faster than overall e-commerce.

The discounts and limited-time offers on daily-deal sites motivate shoppers to splurge on treats such as half-priced golf lessons at Miami's Better Golf Academy, or $75 worth of wine for $35. The sites fall into two categories:

- Group-buying sites, such as Groupon, LivingSocial and BuyWithMe, that partner with small businesses to send subscribers a local offer each day. (Occasionally, they partner with big companies such as Gap to run a national deal.) Subscribers can opt to purchase the voucher, usually good for half off. Then Groupon takes 30 to 50 percent of the revenue. So a pizza parlor might take in only $4 on a pizza it can regularly sell for $16. The theory is that bringing in a bunch of new customers will offset the smaller profit and result in repeat business.

- Flash-sale sites, such as RueLaLa, Gilt and Hautelook, that host limited-time sales for members only. They feature a different product or designer each day, like Dolce & Gabbana dresses that didn't sell or Rock & Republic jeans at 60 percent off. Private sales allow designers to unload excess merchandise and market to more budget-conscious customers while maintaining an air of exclusivity. Woot, a pioneer in 24-hour sales, focuses on gadgets, such as discontinued Flip cameras. Flash sales generally involve limited quantities and can sell out in a matter of minutes.

Skeptics predicted that traffic to daily-deal sites would flatten as the economy recovered and shoppers stopped worrying so much about finding a bargain. The opposite has occurred. LivingSocial had 7 million unique visitors in March, up 27 percent from February, making it one of the 10 fastest-growing websites, according to ComScore. Traffic to Jetsetter, a luxury travel-deal site, has grown tenfold since January 2010. Hautelook's traffic is up 15 percent since Nordstrom Inc., the high-end department store chain, announced plans to buy the site for $270 million in February.

In April, Facebook began testing a daily deals program in five U.S. cities. On May 3, Amazon launched MyHabit.com, which peddles a new luxury item at 60 percent off each day. Groupon rejected Google's reported $6 billion buyout offer last year, but the search giant launched a pilot program called Google Offers in Portland, Ore., in April.

Paul Hurley, 46, started flash-sale site Ideeli in 2007, operating out of his kitchen. Now the company rents space in two New York office buildings. Marketers, programmers and customer-service reps sit elbow-to-elbow.

Ideeli is on track to bring in $250 million in revenue this year, Hurley says, and has 4 million members, triple the number from a year ago. The biggest challenge, he says, is managing the growth. Up to eight fashion shoots are going on at once in the company's studio, and Ideeli has become one of the city's top hirers of models.

Groupon's staff has grown so quickly that the company hired a high-school yearbook publisher to produce a book of employee headshots, trying to maintain the tight-knit community atmosphere of a startup.

"It's really important to us that people still know each other's faces and names," says spokeswoman Julie Mossler, who has been with the company since 2008, when it had 120 workers. It now has 7,000. They include hundreds of former publishing professionals and journalism grads who write the clever blurbs to promote each item. A recent offer for half-priced family portraits started this way: "Ideally, every family would have a group mug shot to display above the mantelpiece; unfortunately, many of today's families are too busy to commit crime together."

Some subscribers find the emails entertaining enough to read daily, even when the deals miss. The need for staff with both marketing chops and the ability to write snappy copy makes finding the right people difficult. Mike Rothman, general manager of Thrillist Rewards, which targets men with offers like the $50 "Strip and Strip" (a strip steak at a gentlemen's club), says he is posting jobs faster than he can fill them. He currently has a dozen openings.

"Our biggest challenge is getting more people on board," Rothman says. "One of the positions we're recruiting for is a recruiter."

Daily-deal sites are thriving because they benefit both merchants and consumers without requiring tech savvy from the former, says Opus Research analyst Greg Sterling.

Some companies have gripes, though. They say that the sudden influx of customers overwhelms staff or that Groupon demands an unfair cut. Groupon responds that it has no shortage of willing partners and that businesses have the option to cap the number of vouchers sold.

The deals work better for some businesses than others. If you're running a hotel and some of the rooms were going to sit empty anyway, it makes a lot of sense. For restaurants, where the profit margin is tiny to begin with, it might be less appealing. (Plus customers tend to tip on the discounted total, making servers grumpy.)

Some merchants don't do the math before they run an offer and wind up getting burned. Businesses hope shoppers will spend more than the coupon's face amount. Other companies are prepared to take a loss, seeing it as a marketing cost. Each of the six business owners interviewed for this story by The Associated Press decided to run a second or third deal after trying it out.

There are hundreds of copycats willing to accept lower commissions, but many merchants prefer to partner with Groupon and LivingSocial because they reach more potential customers. While the business model is here to stay, many of the smaller players will be bought or die, Kerner says.

Facebook has the potential to dominate because it already has 600 million users, dwarfing Groupon's 85 million subscribers, and many businesses already have a presence on the social network.

Small businesses have jumped on the daily-deal model as a way to hook new customers in the digital age. Old ways of advertising no longer pay off, while new ones can be vexing. Newspapers are losing readers, especially young ones. The Yellow Pages is a doorstop. Google search results are unpredictable. Facebook pages are easy to set up, but then what? And reviews on third-party sites like CitySearch can hurt as much as they help.

"We're better than anything that's been out there," says Tim O'Shaughnessy, CEO of LivingSocial.

When Chris Young and his partner started a kayak-tour company, San Francisco Kayak & Adventures, last March, they knew they would need a marketing blitz to get the business off the ground. But a coupon in the San Francisco Examiner didn't produce a single sale. So they decided to try a less conventional form of advertising and ran a Groupon. They were inundated with calls.

Bess Wyrick, creative director at Manhattan floral design shop Celadon & Celery, is thrilled with the results of three deals she's run for flower-arranging courses - a low priority for recession-scarred consumers. The offers brought in more than 1,000 students, who may be inspired to come back for more. But she's not convinced it's a long-term advertising strategy. If you continue to run promotions, she says, "How many of your clients are going to want to buy at the regular price?"