Forecast: Tough times ahead for daily deal sites

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Over the next few years, it is likely that daily deal sites will have to settle for lower shares of revenues from businesses compared with their current levels, and it will be harder and more expensive for them to find viable candidates to fill their pipelines of daily deals, according to Utpal Dholakia, associate professor at management at Rice University's Jones Graduate School of Business. In his third study – the most exhaustive study done to date on the daily deals industry – Dholakia found that there is very little difference between companies in the ever-expanding competition for consumer dollars, and it will be difficult for any one site to stand out from the others.

For the study, "How Businesses Fare with Daily Deals: A Multi-site Analysis of Groupon, LivingSocial, OpenTable, Travelzoo and BuyWithMe Promotions," Dholakia examined performance of daily deals run through five major sites in 23 U.S. markets, which included a survey-based study of 324 businesses that conducted a daily deal promotion between August 2009 and March 2011.

"The major take-away from the study is that not enough businesses are coming back to daily deals to make the industry sustainable in the long run," Dholakia said. "And our results from three studies and close to 500 businesses surveyed show that the deals are nowhere close to the rates of financial success for participating businesses that some companies claim to be having."

Key findings from the study:

- 21.7 percent of deal buyers never redeem the vouchers they've already paid for.

- 55.5 percent of businesses reported making money, 26.6 percent lost money and 17.9 percent broke even on their promotions.

- Although close to 80 percent of deal users were new customers, significantly fewer users spent beyond the deal's value or returned to purchase at full price.

- 48.1 percent of businesses indicated they would run another daily deal promotion, 19.8 percent said they would not and 32.1 percent said they were uncertain.

"Our findings also uncovered a number of red flags regarding the industry as a whole," Dholakia said. "The relatively low percentages of deal users spending beyond the deal value (35.9 percent) and returning for a full-price purchase (19.9 percent) are symptomatic of a structural weakness in the daily deal business model."

The report also points out that 72.8 percent of businesses indicated openness to considering a different daily deal site, and only 35.9 percent of restaurants/bars and 41.5 percent of salons and spas that had run a daily deal said they would run another such promotion in the future.

Other findings:

- On average, close to 80 percent of deal users were new customers of the business, and they spent $64.30 during their visit.

- To increase the likelihood of a profitable promotion, businesses should consider
offering a daily deal of relatively high face value ($50 or more) with a shallow discount (at most 25 percent off face value), a short redemption period (three months or less), and a limit on the number of deal vouchers that consumers can buy.

- Among industries, health, services and special events are the most successful at using daily deals; more than 70 percent of them made money on the promotion. However, two of the largest industries – restaurants/bars and salons/spas – don't perform as well. Only 43.6 percent of the restaurants surveyed earned a profit from the daily deal promotion, and just 35.9 percent of them intend to run another daily deal in the future. 53.7 percent of salons and spas made money on the promotion, but only 41.5 percent of them intend to run another daily deal in the future.

"Since restaurants, bars, salons and spas represent the bread-and-butter for many daily deal sites, these findings raise questions regarding the continued availability of a sufficient pool of viable revenue-generating merchants from these two industries for daily deal sites," Dholakia said.

All traditional marketing programs have been impacted adversely by daily deal spending, according to Dholakia. Spending on Yellow Pages advertising was down 27.5 percent compared with 2009, print advertising was down 21.6 percent and self-managed direct mail was down 17.6 percent. Local radio and TV advertising also dropped substantially, whereas spending on email promotions and online search programs was up substantially (7.8 percent in each case) over the past year.

"The businesses that we see spending their marketing dollars on daily deal sites have dramatically cut their advertising budgets," Dholakia said.

"This is a problem for businesses, because they're not building their brand when they offer discounted prices for their products and services. Only about 20 percent of customers using daily deals return to businesses to buy at full price; customers acquired through other programs typically have much higher rates of full-price repurchases."

All in all, Dholakia said, there is still an upside for consumers and some business types to do daily deals, but he advised caution.

"For consumers, I'd say to be cautious about buying a daily deal. If you're going to purchase a voucher, make sure you use it before it expires," Dholakia said. "Right now the getting is still good for the consumer, but that isn't going to last much longer as these steep discounts won't and can't last very much longer."

More information: To read the complete new study and the previous papers by Dholakia on daily deal sites, visit www.ruf.rice.edu/~dholakia

Provided by Rice University

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