Daily-deals companies tweak models as novelty fades

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Investors have turned skeptical on Groupon, growth has slowed, and hundreds of would-be competitors have disappeared from the crowded daily-deal landscape, but that doesn't mean a fadeout to the era of the discounted restaurant meal or manicure.

Nearly four years after Groupon introduced the concept, smaller rivals that had sought to replicate the Chicago giant's early, explosive success are making tweaks to take advantage of lessons learned - sometimes painfully.

"There was a large amount of exuberance for the first couple of years in the industry, and now players - both on the daily deals side and on the merchant end - have gotten very sophisticated about what works and what doesn't," said Jim Moran, co-founder of Yipit, a deals aggregator that also tracks sector data.

Local advertising and media research firm BIA/Kelsey projects that U.S. consumer spending on online deals will reach $3.6 billion in 2012, doubling last year's figure of $1.8 billion. By 2016, spending is forecast to hit $5.5 billion, though year-on-year growth rates will slow to single digits.

Groupon continues to dominate the field, accounting for more than half of the North American daily deals market, according to Yipit. But the company is also adding new services to expand beyond traditional daily deals, in which Groupon sells vouchers for discounted products or services and shares the proceeds with the merchant.

Smaller companies have used Groupon's model to carve out niches. Chicago startup FamilyFINDS, for example, targets mothers with deals on family-friendly activities and products.

The two-year-old company's deals were initially structured like Groupon offers: Pay $20 for a $40 box of organic fruits and vegetables delivered to your doorstep. Founder and Chief Executive Lindsay Cohen said she encountered three problems: The cost of acquiring customers, mostly through online advertising, was getting too high. Local merchants, burned by poor experiences running offers, were disenchanted with the traditional model. And her members were overwhelmed by emails peddling similar deals, resulting in slower redemption rates.

Last month, FamilyFINDS switched to a subscription model where members pay a $12 annual fee to access deals. They can claim vouchers for free and pay only if they make a purchase at the merchant.

"I always felt Groupon was onto something by being able to bring customers to local businesses," Cohen said.

With the subscription model, merchants keep all the proceeds from deals because FamilyFINDS makes its money through the membership fees.

Candice Blansett-Cummins, founder of Wishcraft Workshop, a children's art studio in Chicago that has run multiple FamilyFINDS deals, said she had "mixed feelings" about the new system. While she liked that the company's merchant and customer base matched her target demographic, she worried that "there's no skin in the game on behalf of the person" who claims an offer. Still, she said she was pleased with the turnout for a recent workshop generated via a FamilyFINDS deal under the new model.

Other daily deal entrepreneurs found room on Groupon's coattails while avoiding direct competition with copycats. Kris Petersen founded Chicago-based DealsGoRound two years ago as a marketplace for buyers and sellers of unused, non-expired vouchers. He raised $300,000 in funding from Lightbank, the local venture capital firm run by early financial backers of Groupon.

Despite the promising start, "I was never under the impression that the pace of the industry was going to keep up," Petersen said. "You knew things would slow down a bit, that we couldn't possibly support 20 new daily deals companies a week launching."

Moran said Yipit has tracked more than 800 daily deal sites since 2009. In the past month, Yipit counts 227 that are still publishing new offers.

Petersen saw a slowdown in his own voucher-reselling business. Last month, he relaunched DealsGoRound as MyCabbage, a service for consumers to share and store not just daily deal vouchers, but all kinds of coupons and gift cards. Petersen raised another $950,000 from local investors and migrated a couple hundred thousand members to MyCabbage.

"The novelty has worn off, so who's left is the people who have really found value in (online deals)," he said. "The users are not out there buying these extravagant deals or things they couldn't otherwise afford. They're buying things for their daily life."

Groupon, which aspires to be the Amazon of local commerce, has evolved beyond its core business of local daily coupons. The company now offers deals on travel getaways and physical products. It provides technology tools for merchants to help them manage customer traffic. This month, Groupon introduced a credit card reader service that can work with mobile devices. The company is diversifying as its quarter-on-quarter revenue growth has slowed from double to single digits.

"It's not that the (traditional local) local deals portion is going to be obsolete," said Mark Fratrik, chief economist at BIA/Kelsey. "It's just that for these companies to grow any further, they have to move into other related types of services."

Industry fragmentation is likely to continue. Dan Hess, co-founder and chief executive of Chicago-based Local Offer Network, said deal providers were unsuccessful trying to undercut each other on the split with merchants - the deal company typically collects 40 percent of the proceeds. The players that stand out will be those that harness technology to better target consumers, who have become "precision shopping machines."

"Deals have been around long before Groupon," said Hess, whose company aggregates daily deals and provides technology for media companies to syndicate or run their own offers. "Deals are another component of the marketing mix, and the evolution that's occurred in most other types of marketing ... is a move from more of a shotgun approach to a more data-driven, disciplined targeting approach."

Hess is a former Tribune Co. executive. Tribune Co. is the owner of the Chicago Tribune and a partner in McClatchy-Tribune News Service.

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