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Small business owners find gold in daily deal websites, but at a cost

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Published: Friday, February 3, 2012 at 6:58 p.m.

A year ago, Tammy Larson decided she needed to infuse some life into her flagging massage therapy practice, so she turned to the Internet.

It was mid-2011 and, while Larson had managed to stay above water during the recession, things were slow. A friend and fellow business owner suggested she try Groupon, a national site that allows business owners to market low-priced deals on goods and services to a wide audience.



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She did. Larson offered an hour-long massage for \$35 — a service for which the 19-year licensed massage therapist usually charges \$75. The results were immediate.

"I was going from (massaging) three to five people a week to five, six, seven a day," Larson said. "It was just that quick."

Larson is among a growing number of small business owners who are reaching new customers through Internet sites like Groupon and local competitors like the Ocala Star-Banner's Bargain Shouter that offer cut-rate deals on goods and services.

Tim Thomas took over as the new owner of Brooklyn's Original Pizzeria and Restaurant in November 2010 and needed a way to get the word out about the eatery's face-lift.

"A lot of people didn't know we had new ownership," Thomas said. "Groupon was one of the places that we picked to advertise."

The Pittsburgh native, who has been in Ocala for about 20 years, said he added some personal pasta dishes to the menu, a higher quality wing sauce and daily soup



Doug Engle/Staff photographer

Tim Thomas, owner of Brooklyn's Original Pizzeria, works on making pizzas and dinners for his customers Tuesday night, Jan. 24, 2012. Some small businesses in Ocala are using Groupon as a way to advertise and attract more business in a sluggish economy. "The last coupon I offered was \$10 for 20. A large cheese pizza and 10 wings. Groupon got \$5 and I got \$5. The wings cost me \$2 a pound," Thomas said. "I'll still use Groupon, but not with that deal again."



specials. He also started to offer beer and wine.

But the key was to get repeat customers. He believed that while he may lose money on the deals, repeat business and additional purchases — such as an extra soda or beer — would make up for it.

"If I get them in the door, they'll come back. And it actually worked," Thomas said.

Thomas offered his first Groupon deal last July to attract some of the area's summer visitors. Roughly 250 people bought the deal, so he advertised another one in December to draw in some of Ocala's snowbirds. He says 210 people bought it.

Other area small businesses have had similar experiences. Jenny Pinard, manager of Easy Street Family Fun Center, said that while the deals are great for her business, she tries to offer deals that won't affect her losses that much.

"We try to keep it where it's not going to hurt our labor," she said.

Which is exactly what happened to one business owner in London last year. The woman underestimated the popularity of the deal — a 75 percent discount on 12 cupcakes, which normally cost \$40. So she ended up hiring temporary staff to help produce 102,000 cupcakes and ended up losing between \$3 and \$5 on each batch she sold.

The Groupon effect

Groupon debuted in November 2008 and within 16 months was valued at over \$1 billion. The company is now valued at close to \$13 billion.

The way the company makes its money is simple: It takes a 50 percent cut of the business' coupon price. So if Tim Thomas of Brooklyn's Original offered \$20 worth of food for \$10, Groupon would make \$5 from that deal.

Businesses decide whether or not they want to put a cap on the number of deals they offer.

What makes Groupon and its competitors different is that the consumer pays for the coupon up front instead of redeeming it upon arrival.

Marketing experts and those that have analyzed the daily-deal phenomenon say small businesses should think of their losses as just another expense.

"You really have to think about Groupon as a marketing expense," said M. Eric Johnson, a professor at the Tuck School of Business at Dartmouth College. "You'll do that advertising and hopefully reap some benefits from that campaign."

Johnson, director of the Center for Digital Strategies at Tuck, said that while it's a gamble for a small business to offer a deal on Groupon, they gain the website's massive consumer audience reach and popularity.

"Getting someone to try you is 99 percent of the battle," he said. "And that's what really people are betting on with Groupon."

But it's up to the merchant to take advantage of that customer patronizing the

business by offering great service or other incentives — such as additional coupons — to influence them to come back.

Without Groupon in the mix the second time around taking a cut of the deal, the business can keep more of the sale.

The daily deal model works best for businesses — such as restaurants — with high fixed income costs such as food, but does not work as well in retail environments with variable costs, Johnson said.

Not everybody loves Groupon

Not all small businesses in the area have jumped on the Groupon bandwagon.

"I don't think you get any bang for your buck with Groupon," said Steve Forrest, owner of Bagelicious. "I don't understand how people are making any money off of it."

Forrest has used other forms of advertising in the past, but his business has been able to thrive through word of mouth and a good reputation in the community.

A study released in June 2011 by Rice University professor Utpal M. Dholakia at the Jones H. Jones Graduate School of Business, showed that 55.5 percent of businesses reported they made money, while 26.6 percent lost money and 17.9 percent broke even. The study examined five major daily deal sites across the country on promotions offered from August 2009 to March 2011.

One of the major conclusions from the study was that a low percentage — 35.9 percent — of customers spent more than the deal value and just 19.9 became repeat customers. The study also indicated that less than half of businesses surveyed would offer another daily deal promotion.

Still, the concept has been successful enough to spawn a raft of competitors.

Livingsocial.com is one of Groupon's biggest growing competitors, and newspapers across the country also have modeled daily deal services after Groupon.

The Ocala Star-Banner launched a local site called "Bargain Shouter." The advantage of local deal sites like that one are they already have an established presence in communities and advertisements also appear in the paper.

"We're local. We've been here for years. You can trust in us," said Mary Manning-Jacobs, advertising manager at the Star-Banner.

Though daily deal services like Groupon and Bargain Shouter draw in new customers, the additional clientele can be a headache.

Larson, the massage therapist, said she works longer hours, gets paid less and is a little overwhelmed. But it beats being slow, she said.

"I had to lower my standard on price to survive," she said. "I do not have any regrets doing that."

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