

The History and Economics of Group Purchasing

- In 1952 John Kenneth Galbraith coined the term “countervailing power” to describe large buyers having an advantage in extracting price concessions from suppliers.
- Conventional wisdom holds that it is an important factor in determining the level of prices.

- But does size alone guarantee purchasing power?
 - Grocery chains cannot typically purchase brand-name products at large discounts over single stores
 - Apple extends very small discounts to *all* retailers for their Macs and iPads, likely a few percentage points off of the official price you find at the Apple Store
- Stay tuned....

Where does the internet figure in this?

- Idea was that internet technologies could be used to “create” large purchasing entities, i.e., customers who wanted to purchase similar things could find each other on the internet and band together, mimicking the power that Wal-Mart has.

Wal-mart Forcing Supplier Discounts

- Wilbert, Caroline. “[How Wal-Mart Works.](http://howstuffworks.com)”
howstuffworks.com.

Early attempts

- Sandoval, Greg and Dawn Kawamoto. “Group-Buying Site Mercata to Shut Its Doors.” CNET News. January 4, 2001.
- Flynn, Laurie J. “Mobshop, a Group-Buying Site, Drops Its Consumer Business.” *The New York Times*. January 15, 2001.

Early attempts (~2000)

- Mobshop and Mercata
- List particular model of Sony DVD player
 - \$100 if up to 5 want to purchase
 - \$95 if 6-25 want to purchase
 - \$90 if 26-100 want to purchase, etc.
- Must commit to buy at current price but may get lower price.
- No way to communicate cross-price elasticities.

Groupon

Harbison, Niall. “The Rise of Group Buying Sites and How Social Is Crucial to Their Success.” Simply Zesty. September 16, 2010.

Tobin, Jim. “Group Purchasing: The Next Big Idea in Social Commerce Has to be More Than a Deal a Day.” Ignite Social Media. April 17, 2010.

How Groupon is different from early attempts

- Groupon focuses on repeat-purchase items or experiences---Mobshop and Mercata dealt mostly in consumer durables---so discounts are like coupons.
- Groupon has purchasers pay up front with the ability to use within six months (1/5 never do).
- Groupon gives sellers a free advertising campaign.
- Groupon gives sellers contact information of buyers.
- Price does not depend on the number of purchasers (although it used to), so really not a group purchasing site at all!

Sources of countervailing power

TABLE I
SUBSTITUTION OPPORTUNITIES FOR VARIOUS CHANNELS AND DRUGS

Drug Category	Hospitals, HMO's	Drugstores
1. On-Patent, Branded Drugs		
a. Therapeutically Unique	Poor	Poor
b. Not Therapeutically Unique	Moderate	Poor
2. Off-Patent, Branded Drugs		
a. Mandatory States	Excellent	Poor
b. Permissive States	Excellent	Moderate
3. Generic Drugs		
a. One Generic Manufacturer		
i. Mandatory States	Excellent	Poor
ii. Permissive States	Excellent	Moderate
b. Multiple Generic Manufacturers	Excellent	Excellent

Notes: Mandatory states require drugstores to fill prescriptions with the generic unless prescriber or purchaser explicitly request otherwise. Permissive states make this optional for the pharmacist. According to the *National Pharmaceutical Council* [1992], Florida, Hawaii, Kentucky, Massachusetts, Mississippi, New Jersey, New York, Pennsylvania, Rhode Island, Virginia, Washington, and West Virginia were mandatory states as of 1992 and the rest permissive.

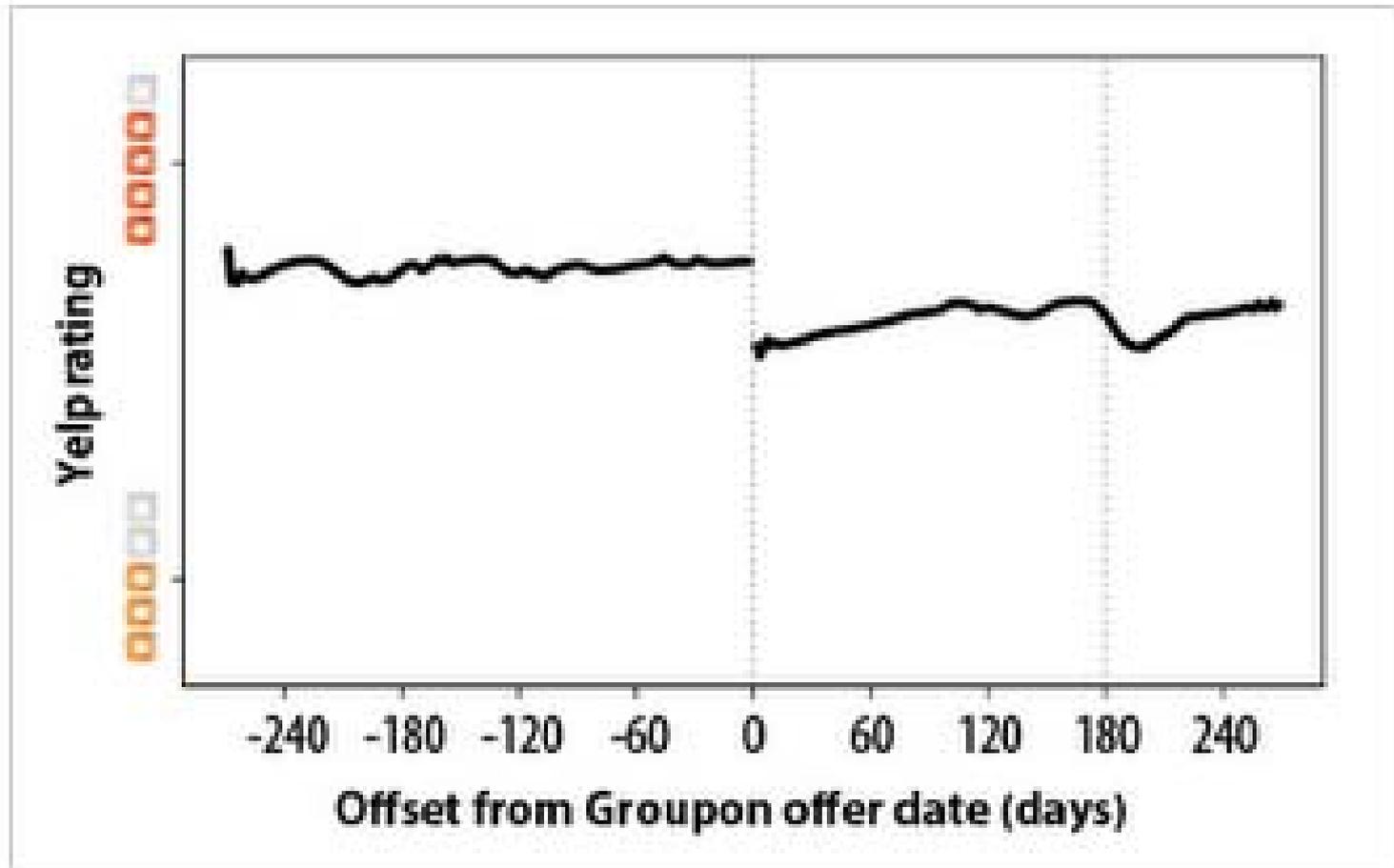
Main points

- Buyer size effects emerge in economic models both with and without seller competition.
- Empirical evidence suggests seller competition quite important, though.
- Perhaps contributing to the failure of Mercata and Mobshop was their inability to induce seller competition.
- Perhaps contributing to Groupon's pivot away from group purchasing was their realization that they could not induce seller competition.

But is everything sunny for Groupon?



Groupon deals and seller reputation



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14.27 Economics and E-Commerce
Fall 2014

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