Case Study: Promotional Price Analysis

Financial Analysis for Marketing Strategy

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Wildfire Steakhouse & Wine Bar at Cosmopolitan Hotel: Toronto, ON.
Case Study: To do a Group-On Ad or Not?

1.0 Business Problem/ Situational Assessment

The problem we are looking to solve if what advertising promotion would provide the greatest return in terms of net profit. All factors remain constant except advertising method: GroupOn or Discount offers on selected days using Social Media Combined with traditional (previously used) advertising methods. (Appendix 7.1)

2.0 Objective

- Maintain a margin of safety within 2 million dollars difference from base
- Maintain a net profit margin and gross margin of at least 50%

3.0 Alternatives Considered

- Base; GroupOn (option 1); Social Media and Billboard (option2)
- *View Appendix 7.2 for rational behind alternatives*

4.0 Pro-forma and Breakeven Analysis Shortlist

Assumptions	Base	Option 1	Option 2
Total Quantity	**55,296**	**61,440**	**61,440**
Per-Forma Income Statement			
Total Sales	**$9,953,280.00**	**$9,400,320.00**	**$9,400,320.00**
Total COGS	**$1,769,472.00**	**$4,104,192.00**	**$4,104,192.00**
Gross Profit	**$8,183,808.00**	**$5,296,128.00**	**$5,296,128.00**
Total Fixed Costs	**$135,000.00**	**$1,576,896.00**	**$169,000.00**
Net Profit	**$8,048,808.00**	**$3,719,232.00**	**$5,127,128.00**
Analysis			
Gross Margin	82.22%	56.34%	56.34%
Net Profit Margin	80.87%	39.56%	54.54%
% Change in Sales	-	-6%	0%
% Change in Net Profit	-	-54%	-36%
Breakeven Analysis			
Breakeven ($)	$164,189.19	$2,798,898.93	$299,965.20
Margin of Safety ($)	$9,789,090.81	$6,601,421.07	$9,100,354.80

5.0 Recommendations with rational

It is recommended to choose Option 2, using social media with traditional advertising instead of GroupOn.

- Option 2 achieved a margin of safety of $9,100,354.80
- Even though there is a higher breakeven point due to advertising costs, the raise in awareness will pay off in the long run.
- Net profit margin is 54.54%, which meets our objective
- Gross margin is 56.34% for both options, but considering the other facts, option 2 makes the most sense

6.0 Sources

Bhasin, K. (2011). This Bakery Had to Make 102,000 Cupcakes Because Of A Groupon Deal And Lost A Ton Of Money. *Business Insider; Retail*. Retrieved from: http://www.businessinsider.com/london-baker-makes-102000-cupcakes-groupon-deal-2011-11#ixzz1ecvJBji3

Decker, S. (2010). Analyzing GroupOn Profitability (7 Factors for Group Buying Sucessess). *Decker Marketing*. Retrieved from: http://decker.typepad.com/welcome/2010/10/analyzing-groupon-profitability-7-factors-for-group-buying-success.html

Queen's Park. (2015). Ontario's Minimum Wage to Rise to $11.25, second-highest in the country. *Toronto Star Newspaper Ltd*. Retrieved from: http://www.thestar.com/news/queenspark/2015/03/19/ontario-minimum-wage-to-increase-to-1125-in-october.html

7.0 Appendix

7.1 The Case

7.1.1 Assignment Instructions

For your Case Work this week, students are to prepare a formal written proposal of your recommendation. The written proposal will include (1) Business Problem (2) Objective (3) Alternatives Considered (4) Proforma and Breakeven analysis comparing shortlisted alternatives (5) Recommendation with rationale for your recommendation. Your proposal should not be more than 3 pages long.

This week you will evaluate the appropriateness of Group-On offer over traditional advertising to drive new business. For this case you have to first calculate the base case, and then just compare two alternatives, additional traditional advertising OR continue with Groupon.

When a business signs up for a Groupon offer, the typical financial arrangement is that the merchant/business doesn't pay an advertising fee. Instead, the business agrees to offer a minimum of 50% discount on their "regular" pricing. And they also pay as much as 50% of the sales to Groupon as a "commission". So this converts the advertising costs from a fixed cost to a variable cost.

Example: If your regular price is $180, the business offers a discount of 50% to the consumer, so that the markdown price is now $90. Then, 50% of each sale is paid to Groupon, or $45. That means that if the Groupon offer generates 10 coupons sold @ $90 each, the business pays $450 to Groupon in "advertising costs".
The details of both cases are provided here: Group On Case Situations Spa and Restaurant.docx

7.1.2 Case Information

Wildfire Steakhouse & Wine Bar at Cosmopolitan Hotel in downtown Toronto has been using GroupOn offers for some time now. But it doesn't appear to be providing the value that was initially imagined.

So they are reconsidering whether they should revert back to their traditional advertising.

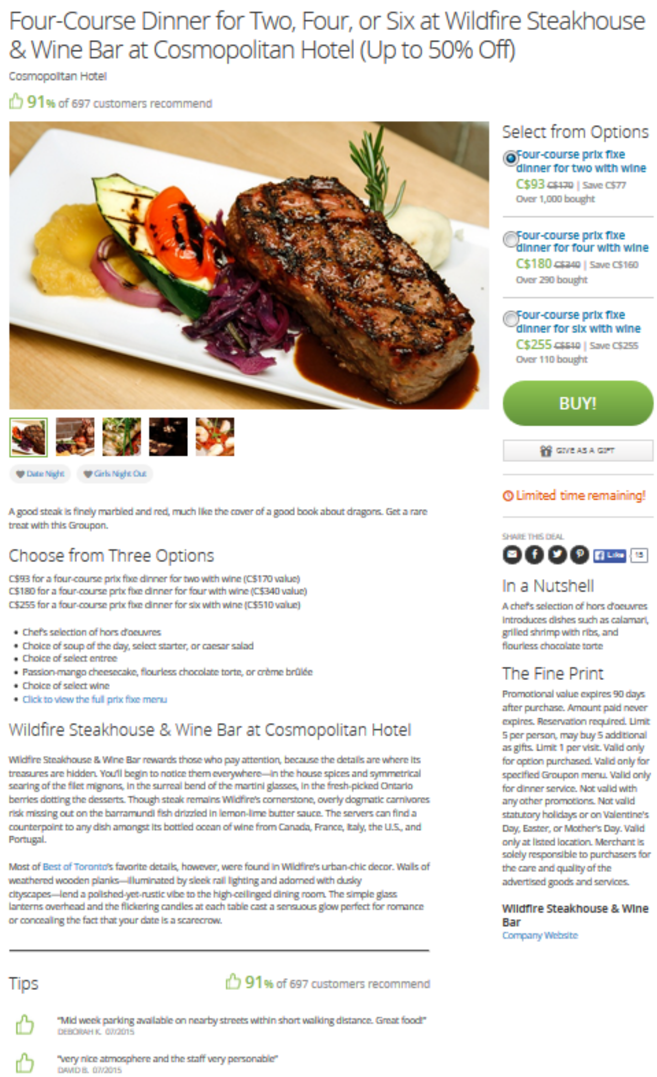
A typical **table for four** spends about $180.00 per visit. The cost for preparing the meals is approximately $32 per table of 4 in variable costs (ingredients) excluding alcohol. The monthly operating expenses for the restaurant totals $10,000.

There are 40 tables (4 persons per table) and they generally have 4 seatings a day. On weekdays, Tuesday, Wednesday and Thursday, they are typically operating at about 20% capacity. On Fridays and Saturdays, they are operating at 80% capacity. They are currently closed Sunday and Mondays. 80% capacity is a perfect number for maximum customer experience, don't want the place to be TOO crowded and want to be able to keep up with the orders.

Before GroupOn campaign, Wildfire manager, Geoff, would just use additional advertising in city newspapers and some travel destination magazines. The cost for these typically ran at about $3,000 per month and used whenever they need to "boost" occupancy. Geoff has always believed the advertising has worked, but unfortunately he never tracked the effectiveness of advertising before doing the GroupOn offer.

What do you recommend that Geoff do? Should he continue with Groupon or go back to traditional advertising?

Source:
https://www.groupon.com/deals/wildfire-steakhouse-wine-bar-cosmopolitan-hotel



7.2 Reasoning Behind Figures

7.2.1 Reasoning for Base Figures

Given:
- At 100% Capacity, there are 160 tables sat per day (40 tables * 4 table change overs)
- Restaurant is closed on Sundays and Mondays

Assume:
- Additional marketing efforts to maintain achieving capacity levels in the months of November, December, January, February and March (Knowledge based off of own experience)
- Advertising costs are: $ 15,000 (5months*3,000 for advertising)

Figure 2.1

	Base Quantity	
Time Period	Capacity Level	Number of Tables Sat
Tuesday	20%	192
Wednesday	20%	192
Thursday	20%	192
Friday	80%	228
Saturday	80%	228
TOTAL PER WEEK		**1,152**
PER MONTH		**4,608**
PER YEAR		**55,296**

7.2.2 Reasoning for GroupOn Option

- Assume hosts do not allow capacity to reach over 90% to ensure no over crowding
- When at capacity of 90% hire another 5 staff (3 servers, and 2 cooks), each being paid $9.80 per hour (Queen's Park, 2015)
- Assume staff work 8 hour shifts
- Additional fixed costs for staff when capacity is at 90% is **$392.00** (5*9.80*8)
- This becomes a fixed costs, for additional staff comes in every Friday and Saturday
- Assume 30% of sales come from GroupOn

Figure 2.2

Price 1: GroupOn			
Time Period	Capacity Level	Number of Tables Sat	Additional Costs for Staff Wages
Tuesday	30%	208	0
Wednesday	40%	224	0
Thursday	50%	240	0
Friday	90%	304	$ 392
Saturday	90%	304	$ 392
TOTAL PER WEEK		**1,280**	$ 784
PER MONTH		**5,120**	$ 3,136
PER YEAR		**61,440**	$ 37,632

7.2.3 Reasoning for Social Media and Traditional Advertising Option

- Discount offers on selected days using Social Media Combined with traditional (previously used) advertising methods for three months to maintain sales.
- Social media management will cost hiring a content manager full-time employee for about **<u>$ 40,000</u>** per year (who is able to handle art direction)
- Social Media budget is 3,000 per year
- Traditional advertising, for 3,000 a month for 3 months, comes to **<u>$ 9,000</u>** (3,000*30)
- Discount items only available on Tuesdays, Wednesday, Thursday
- Assume 30% of all sales come from advertising efforts

Figure 2.3

Price 2: GroupOn			
Time Period	Capacity Level	Number of Tables Sat	Additional Costs
Tuesday	30%	208	
Wednesday	50%	224	
Thursday	60%	240	
Friday	80%	304	
Saturday	80%	304	
TOTAL PER WEEK		**1,280**	
PER MONTH		**5,120**	$ 9,000 + $40,000
PER YEAR		**61,440**	$ 49, 000

7.3 Pro-forma and Breakeven Analysis

Assumptions	Base	Option 1	Option 2
Quantity at Regular Price	55,296	43,008	43,008
Quantity using GroupOn	-	18,432	18,432
Total Quantity	**55,296**	**61,440**	**61,440**
Regular Selling Price	$180.00	$180.00	$180.00
VC/ Unit	$32.00	$32.00	$32.00
Contribution/ Unit	$148.00	$148.00	$148.00
Discounted Selling Price	*N/A*	**$90.00**	*$90.00*
Advertising Costs/ Unit	*N/A*	*$45.00*	*$-*
Total VC for Discounted	*N/A*	$77.00	$32.00
Contribution/ Unit with Discount	*N/A*	**$13.00**	$58.00
Per-Forma Income Statement			
Sales at Regular Price	$9,953,280.00	$7,741,440.00	$7,741,440.00
Sales Discount	$-	$1,658,880.00	$1,658,880.00
Total Sales	**$9,953,280.00**	**$9,400,320.00**	**$9,400,320.00**
COGS on Discount Price	$-	$2,727,936.00	$2,727,936.00
COGS on Regular Price	$1,769,472.00	$1,376,256.00	$1,376,256.00
Total COGS	**$1,769,472.00**	**$4,104,192.00**	**$4,104,192.00**
Gross Profit	**$8,183,808.00**	**$5,296,128.00**	**$5,296,128.00**
Total Advertising Costs	$15,000.00	*$1,419,264.00*	*$49,000.00*
Fixed Expenses	$120,000.00	$120,000.00	$120,000.00
Other Fixed Expenses	$-	$37,632.00	$-
Total Fixed Costs	**$135,000.00**	**$1,576,896.00**	**$169,000.00**
Net Profit	**$8,048,808.00**	**$3,719,232.00**	**$5,127,128.00**
Analysis			
Gross Margin/ Contribution Margin	82.22%	56.34%	56.34%
Net Profit Margin	80.87%	39.56%	54.54%
Advertising as % of Sales	0.15%	0.00%	0.52%
% Change in Sales	-	-6%	0%
% Change in COGS	-	132%	132%
% Change in Advertising	-	9362%	18086%
% Change in Net Profit	-	-54%	-36%
Breakeven Analysis			
Breakeven ($)	$164,189.19	$2,798,898.93	$299,965.20
Margin of Safety ($)	$9,789,090.81	$6,601,421.07	$9,100,354.80