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MARKETING & STRATEGY

Liquor Giant Targets System Dating to End of Prohibition

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Earlier this year, Greg Connolly, the head bartender at the legendary Four Seasons restaurant in New York, heard a pitch about a new $30-a-bottle "superpremium" vodka named Ciroc, distilled from French grapes instead of the traditional grain. It seemed like a crazy idea: There's a glut of high-end vodkas on the market, the economy is lousy and French brands were unpopular around the time of the Iraq war.

Then the Ciroc salespeople showed up. Specializing in swanky restaurants, they wielded market research showing why a grape-based vodka would appeal to Four Seasons' clientele. They spent hours in the bar, holding tastings for the bartenders and buying drinks for customers. In the end, not only did Mr. Connolly take the product, he even created a vodka and champagne cocktail called Ciroc Rocks.

"Get the bartenders hooked on it," he says. "That's how it's going to sell."

The charm assault by the Ciroc salespeople is just one example of how the vodka's creator, Diageo PLC of London, hopes to transform the way liquor is sold in the U.S., an antiquated system that dates to the end of Prohibition.

For 70 years, booze purveyors have grappled with restrictions aimed at ending the mob influence that had permeated the business in the 1920s and early 1930s. Spirits makers are barred from selling directly

to liquor stores, restaurants and bars, for example. Instead, they have to go through a tier of huge wholesale distributors, and thus have had little control over how their products are presented to consumers.

Sales reps from the liquor distributors often show up at bars and liquor stores with a Diageo product under one arm and a rival's under the other, making it tough for manufacturers to implement marketing strategies. A hodgepodge of state-by-state regulations means some liquor retailers are state-owned, some are large grocery chains and many are mom-and-pop "package stores." No mass-market retailer has emerged.

Those restrictions also explain why, in contrast to the palatial supermarkets and ubiquitous convenience stores where beer is often sold, many liquor stores seem frozen in time, with their products piled up in drab displays. The big food and consumer-products companies are free to sell directly to retailers, and work closely with them to showcase their wares on eye-catching platforms. Spirits makers can't.

Diageo wants to break through the clutter and thinks it has the clout to do so. Eighteen months after it won control of liquor giant Seagram, Diageo now owns 10 of the top 20 spirits brands in the U.S. and holds a 23% market share, nearly two times its nearest U.S. rival, Future Brands LLC, according to Banc of America.

Diageo is using its leverage to sign five-year contracts with its distributors. Under the pacts, distributors agree to create dedicated sales forces to secure more and better shelf space for its brands, launch marketing campaigns for new premium products and glean consumer feedback from retailers. Diageo is also naming just one distributor in each state to handle its goods.

What's more, the company is training its distributors' sales forces in more sophisticated targeting techniques. Some now specialize in the Hispanic community, differentiating between Dominican and Puerto Rican consumers in New York, for example. Salespeople dedicated to high-end establishments are being taught how to pitch products such as in-room silver platters featuring Diageo brands.

In addition, Diageo is helping distributors assemble retailer profiles and funnel consumer feedback to the company. For instance, Diageo will not only know the pricing of a particular country club's wine and food list, but up-to-date data on sales at that club will allow salespeople to better pitch the club a new or existing product.

"If they wanted to know how much Smirnoff raspberry is sold in Italian restaurants in Queens, we can tell them," says Nino Magliocco, president of Peerless Importers Inc., the Diageo distributor in New York state.

Paul Clinton, president of Diageo North America, calls the strategy "a long-term transformation that has never been undertaken in wine or spirits across the country."

Most distributors want Diageo's business, since it owns so many major brands, but Mr. Clinton acknowledges there will be "bumps in the road." While the new agreements reward distributors for boosting sales, they could also hurt them if Diageo's products falter, since some of them derive half of their volume from Diageo's products. Last year, for instance, Captain Morgan Gold, a premixed drink, flopped spectacularly, forcing Diageo to buy back millions of dollars in unsold product.

PRIME SHELF SPACE

Diageo leads the market in distilled spirits sales. Estimated 2002 U.S. market share:

COMPANY	SAMPLE BRANDS	MARKET SHARE
Diageo	Captain Morgan, Smirnoff	23.0%
Future Brands*	Absolut, Jim Beam	13.7
Constellation Brands	Black Velvet, Montezuma	10.7
Bacardi	Bacardi rum, Dewar's	8.3
Allied-Domecq	Kahlua, Beefeater	7.6
Brown-Forman	Jack Daniel's, Southern Comfort	7.1
Heaven Hill Distilleries	Evan Williams, Christian Brothers	4.8
Schieffelin & Somerset	Hennessy, Tanqueray	4.2
Pernod Ricard	Chivas Regal, Wild Turkey	3.9
Other		16.7

*A joint venture between V&S Vin & Sprit and Jim Beam Brands

Source: Impact Databank, Banc of America Securities

The head of a wholesalers' trade group gives qualified approval to Diageo's new system. "If the brands grow as expected due to Diageo's marketing and our selling, it becomes a very positive deal. If the brands don't grow for some reason, if the extra resources don't produce growth, it will be a bad deal for everybody," says J. Smoke Wallin, president of the Wine and Spirits Wholesalers of America.

One big rival says Diageo's size could pose a problem for its plans. "The dynamics of the last six months [as Diageo implemented its new system] have created a lot of tension and fear among distributors who don't want to be reliant on one supplier," says Tom Wilen, president of Allied Domecq Spirits North America, a unit of Allied Domecq PLC. "That has created opportunity for us because distributors see us as less threatening."

Yet if it succeeds, Diageo could strive to emulate what Anheuser-Busch has accomplished in the beer industry. In part by fostering a more exclusive wholesale system in the 1990s, Anheuser-Busch now has a 52% share of the U.S. beer market, up from 28% in 1980, according to Impact, which monitors the industry. The power of this system is such that Anheuser-Busch can roll out a new product nationwide in just three weeks.

Diageo falls well short of that dominance, but it seems poised to grow.

"Diageo could easily mop up 10 points of market share over the next five years in the U.S.," says Bryan Spillane, a Banc of America Securities analyst. (BOA rates Diageo stock at "neutral.")

Analysts expect the Diageo move to help spur another round of consolidation among rivals who don't have the must-have products to force similar deals. Bacardi Ltd. and Brown-Forman Corp. have formed an alliance to pool salesforces; Allied Domecq and Pernod Ricard SA have consolidated their distributors and worked out agreements to execute marketing plans more efficiently. These rivals also expect that wholesalers that weren't chosen by Diageo to be its distributors will be motivated to promote their products better than in the past. Pernod last year introduced a new vodka for distributors who lost Diageo's Smirnoff brand, for instance. "We don't feel in any way intimidated," says Richard Burrows, Pernod's co-managing director.

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