

INFORMATION WEEK

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E-BUSINESS ONLINE SALES

Alcohol Goes Online Overcoming Regulatory Maze

WEB SITE SIMPLIFIES ORDERING FOR INDUSTRY THAT HASN'T CHANGED MUCH SINCE PROHIBITION

The beverage alcohol industry is designed to be purposely inefficient and deliberately slow moving, thanks to huge amounts of burdensome and complicated government regulation. So how do you take such an industry online and transform it so it moves at Internet speed?

You don't change the industry business model to conform to the Net; you adapt the Internet model to accommodate the industry's traditional way of doing business.

That's the goal—and challenge—of eSkye.com Inc., a new online liquor Web site that is taking a unique approach in

an unusual industry. Rather than attempt to change the rules, as many other E-businesses have done, eSkye.com is trying to modernize an industry that's forced to live under decades-old rules imposed by federal and state governments.

The eSkye system is designed to let



Stephen Hill

CHANGING THE RULES: eSkye.com developed software to suit the needs of the \$110 billion beverage alcohol industry, CEO Wallins says.

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NO MORE BACKWATER: Sales staff can spend more time promoting specials than logging orders under eSkye's Web sales system, says Lipman, president of Lipman Bros. liquor distributors.

retailers—bars, restaurants, and liquor stores—place orders for spirits online around the clock. Attempting to use the system shows just how unusual the industry is—you need a state liquor license to sign on to the Web site. By using eSkye, retailers should be able to take care of their liquor needs quickly rather than spending hours talking to and placing orders with salespeople from several distributors. E-Skye then transmits the orders directly to the appropriate distributor, which, in some cases, are organizations run by state governments.

eSkye is taking a state-by-state approach because of the different laws regulating liquor distribution. It has recently finished several weeks of tests and plans to debut in Michigan, Indiana, and Illinois this month. New Hampshire is next on its list. The Indianapolis company also plans to launch pilot programs this month in 16 more states and the District of Columbia. These pilot programs will let eSkye service up to 43% of the \$110 billion U.S. beverage alcohol market.

eSkye.com has signed agreements with about 35 of the nation's 4,500 liquor distributors, including seven of the top 10 and about 300 retailers. "We've purposely been going slowly," says J. Smoke Wallin, eSkye.com's founder and CEO, whose family has been a liquor distributor for decades. "We want to make sure

we get it right."

Although eSkye's efforts to move purchasing online may seem routine to many industries that are creating Internet marketplaces and exchanges on a daily basis, it's a major change for the liquor industry, which is divided into beer, wine, and distilled spirits segments, with a patchwork of distributors and laws. While most E-commerce Web sites attempt to eliminate the middleman, the liquor industry can't do that.

Ever since the repeal of Prohibition in 1933, federal and state government agencies have passed laws and set up a system that requires liquor manufacturers to sell to distributors, which maintain rigidly controlled geographical territories. Distributors can sell only to retailers such as bars, restaurants, and liquor stores, which in turn sell to individual consumers. In some states, government-run stores are the only places that can legally sell a bottle of scotch or gin—there are no privately owned liquor stores. This three-tier system was designed to keep organized crime out of the liquor business and collect taxes. While the system has accomplished those two goals, it also has stifled an industry by imposing and keeping intact a distribution chain that relies on middlemen.

Salespeople from distributorships visit retailers and take orders using

paper and pencil. The orders are submitted to the home office using a hand-held electronic device that is customized for a distributor's products. It is used to record orders and transmit that information over phone lines to suppliers. According to industry estimates, these administrative tasks can eat up 40% to 60% of a salesperson's time because of the large number of products. There are more than 15,000 products in the beer, wine, and spirits industry when different sizes of the same product are taken into account.

This manual approach forces a restaurant's beverage manager, for example, to talk to a dozen or more sales reps each week, each representing a different distributor of a specific brand of liquor that the restaurant wants to carry. As a result, the restaurateur spends a lot of time placing orders, and very little learning about new products or special promotional offers.

"Our question was: How could we get closer to the customer," says Wallin. "And how could we do it in a neutral way so we didn't promote one brand or distributor over another?"

So Wallin created eSkye.com, which he named after his son, Skye. And he decided that the key to success was to get distributors on board. Although several of them jumped at the chance, many saw it as a threat to the way they had been doing business since the 1930s.

But Wallin had some convincing arguments. The main selling point: Doing



CONVENIENCE: Archer Liquors owner Tomaras can order on his schedule via the Web site.

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business via a Web site can cut the cost of taking an order from \$6 to \$9 to less than \$1. Wallin also decided to make eSkye even more appealing by taking 15% of the company's private, common stock as warrants and offering them to distributors that joined. "We did it in a way so if we were successful, they would be successful," says Wallin. The service is free to retailers, and eSkye receives a small fee for each transaction from the distributor.

Wallin also designed his Web site so it

would appeal to and be easy to use by those not familiar with computers. The Web site allows point-and-click ordering, using proprietary software dubbed "eBots" that the company built to take into account the myriad discounting and pricing schemes that vary by state.

The company decided to use the Microsoft BackOffice Server Suite 4.5, which includes SQL Server 7.0, Systems Management Server 2.0, Exchange 5.5, SNA Server 4.5, Site Server 3.0, Proxy Server 2.0, and Windows NT Server 4.0,

because it was reliable and easy to use, according to eSkye President Andrew Lobo. The system is designed to scale up by adding more servers so it can handle 500,000 customers, which is the total number of liquor retailers (restaurants, bars, and stores) in the United States. "Even if everyone ordered at once, we could handle it," Lobo says.

With the scalability issue apparently solved, eSkye is working on reliability. Nearly one-third of the site is mirrored on multiple servers, and it's aiming for

State-By-State: Web Site **Retails** Online Spirits

ESkye.com Inc.'s business model aims at the retail liquor market. Drinks.com, on the other hand, targets the individual drinker.

After paying \$100,000 last year for the coveted domain name, the company is up and running in three states—California, Florida, and Illinois. Because it must adhere to the three-tier, state-imposed system of alcohol distribution, the company has partnered with Drinks America Inc. in Waukegan, Ill., which is setting up licensed retail operations in the states in which Drinks.com customers are legally permitted to order liquor online.

"Drinks America can only fulfill orders from us," says Drinks.com CEO Louis Amoroso. The company hopes to begin service to customers in New Jersey and New York in May, and eventually expand to 26 states where its operations are permitted. "These states will give us access to 90% of the U.S. population," Amoroso says.

The company's biggest business challenge has been to achieve 48-hour delivery after a customer clicks on one of the 15,000 little pictures of wine, beer, or spirits on its Web site. After an order is placed, it is relayed to Drinks America, which sends the order to a distributor, who then ships the product to Drinks America in one day. The customer gets the order via United Parcel Service within the next 24 hours, although some orders in large states like California may take three to five days.

Technically, the biggest challenge was to build a Web site to handle each state's prices, regulations, and age requirements for each of the 15,000 products. The company is using Microsoft's Site Server, SQL Server, and Message Queue Server. Drinks.com chose off-the-shelf products because it wanted to get the Web site up and run-

ning fast; it took the company only six months. The biggest hurdle was hiring an IT team and transferring knowledge from consultants to the in-house IT staff.

Pricing is key. Amoroso says his prices are lower than those at neighborhood liquor stores, and equal to or lower than big liquor stores. Shipping, however, can be a factor

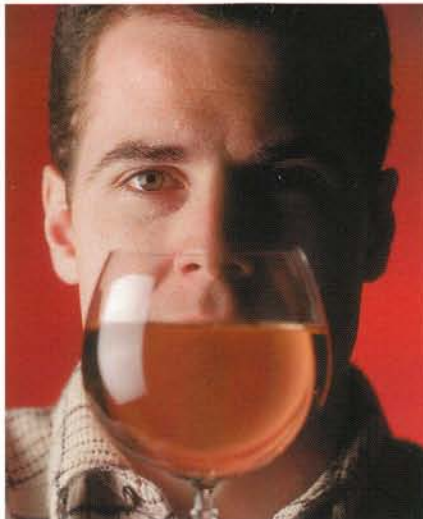
for small orders. There's an initial shipping charge of \$3.95 per order, and an additional charge of 50 cents to \$1 per bottle or six-pack. But there are discounts for larger orders.

Another challenge was to assure state regulators that underage drinkers would not be served. Several layers of verification are in place at the Web site, including a check of driver's licenses that Drinks.com automatically verifies against state records in real time. When receiving the delivery, the customer again affirms that he is of legal age. The company also warns that it will prosecute underage drinkers.

Drinks.com also says it provides education about its products. The company has hired writer/drinkers, whose experience as tasters and critics lets them write original articles, cull through the best recipes, and

offer suggestions about high-end products, especially wine and beer.

"Drinks.com isn't meant to be just an E-commerce site, but an affinity portal," says Amoroso. Drinks.com also hopes to add an online magazine with news and features. It has hired James Gordon, former managing editor of *Wine Spectator*, to be editor-in-chief and lead a team of four journalists who have amassed 49 years of journalistic experience and quaffed more than 49,000 bottles of wine, beer, and spirits. —LARRY KAHANER



WHAT YOU WANT: CEO Amoroso envisions Drinks.com as an affinity portal, not just a site that lets users order alcohol online.

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100%. "Our biggest decision was to do our own hosting. We wanted control if anything went wrong," Lobo says.

One distributor who didn't need much convincing to participate in eSkye was Robert Lipman, president of Lipman Bros. in Nashville, Tenn. "Salespeople prefer to spend more time marketing; with eSkye, they can call on more accounts, and they can develop new ones," he says. "The wine and spirits business has been in a backwater," notes Lipman, who is also on eSkye's board. "This allows us to get involved in the Internet."

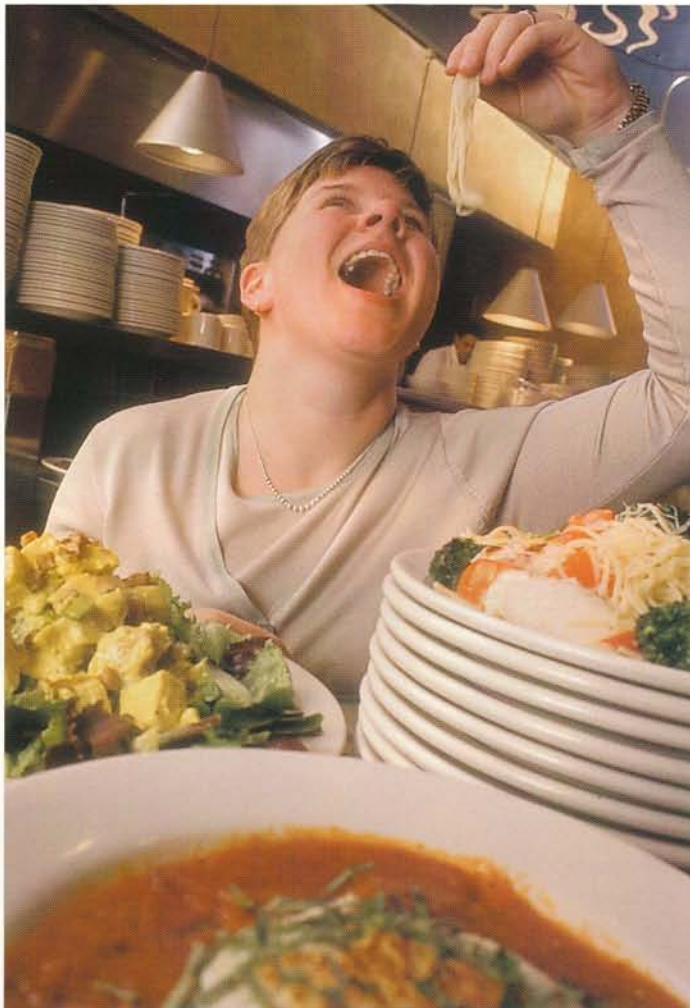
Distributors such as Lipman are also looking forward to the day when they can sell distressed or discontinued goods on eSkye. Since distributors only have a limited number of outlets (by law, retailers are the only outlets), they often let go of cancelled or unpopular brands for pennies on the dollar. They hope that eSkye may some day allow them to use an eBay-like auction that will reach more potential customers who might be interested in bidding on these leftovers.

For retailers, the most important aspect of eSkye is the flexibility it allows. "It gives me an opportunity to order when I want, not just when a salesperson is here," says Dean Tomaras, owner of Archer Liquors in Chicago, a store with 3,000 square feet of selling space. He says the Web site also can help him find a distributor for an obscure product that a customer requests.

"It's quicker and easier than the old way," says Kelly Stafford, manager of Tillis Restaurant in Chicago, a 150-seat establishment that spends \$2,000 to \$3,000 a week on liquor. "I can do my orders on Sunday night, after I do my inventory, and I can have it by Tuesday," she says. "It has taken a lot of stress out of my job."

Dave Wilson, executive VP for sales and marketing at National Wine and Spirits in Chicago, which is Wallin's

liquor distribution company, says he may follow the example set recently by companies such as Ford Motor Co. and buy computers for his 400 sales reps in Illinois. "Right now, we have salespeople taking orders on the backs of paper bags," he says. "I want them to stop being order takers. I want them to have true



STRESS-BUSTER: Chicago restaurateur Stafford says the anytime ordering aspect of eSkye's Web site has taken a lot of the anxiety out of her job.

sales time with the customer to present new products and distributor opportunities." Some of the opportunities may include what's called "point of sale" products such as paper cups, napkins, and ashtrays. Wallin hopes restaurateurs will one day order these items through eSkye.

Another big benefit that eSkye hopes to offer is data collection. Because of the fragmented nature of the industry, manufacturers don't have national sales and

marketing information. Until eSkye came along, there was no nationwide coding system of liquor brands and products, so there was no way to provide national market or sales data to the manufacturers. "For the first time, we can give the manufacturers this information," Wallin says. Such data could

one day be an important element of eSkye's revenue, perhaps generating as much as 20% of its income, he says.

eSkye still faces some formidable challenges. Some distributors will never join, which could put a damper on hopes for nationwide coverage and signing up some national restaurant chains. One distributor who asked not to be named says he won't participate in eSkye because he's developing his own Internet-based ordering system. "We're big enough that we can do that," he says.

Other Internet-based competitors are selling liquor directly to individual consumers. Wallin says eSkye's key challenges are keeping the system reliable while building its database of products and customers, and connecting retailers to the Internet. Many restaurants already order food online, so Wallin hopes to leverage that ability to get them to order liquor. "Getting buyers on board is their real issue," says Steve Kafka, an analyst with Forrester Research.

Wallin says ease of use should help to attract more customers, plus the ability to

offer retailers better deals from distributors because salespeople and the Web site will alert them to promotions.

The company has also set its sights outside the United States. Wallin is visiting England and Hong Kong, hoping to learn the quirks in each country's system and use the eBots system to exploit it.

What's next on the menu for eSkye? "Beer," says Wallin. "Beer is the next frontier."

—LARRY KAHANER