eSkye.com

Smoke Wallin—founder and CEO of eSkye.com—lifted a large wine snifter and slowly finished the last sip of Pinot Noir. The tables around Smoke in the trendy Indianapolis café were emptying as the business crowd hurried back to work. On his left sat Andrew Lobo, president of the fledgling start-up company and former business school colleague. "This is the biggest and best deal in America right now," concluded Smoke to his third lunch companion. "It's Providence as much as anything," added Lobo. "The intersection of three crucial components—opportunity, strategy, and the ability to execute."

eSkye.com was a groundbreaking business-to-business on-line product ordering solution for the $110 billion US alcohol-based beverage market. It was born out of the idea of improving the inefficient and costly alcohol beverage supply chain. The goal of the company was to seamlessly link the nation's alcohol beverage retailers, wholesalers, and suppliers through web-based on-line ordering and information sharing across all groups in the chain. If successful, the consolidated ordering approach would solve one of the most significant problems facing the industry – the costly manual process used by retailers to place orders with multiple wholesalers. eSkye was in the final stages of a string of successful pilot programs in Indiana, Illinois, and Michigan and was preparing for a February 2000 roll out of its ordering and inventory tracking system to a larger set of customers.

As they continued to expound about the virtues of eSkye, the third lunch partner, a student at a well-known business school, began to grasp the implications and opportunity in the venture. But there were also challenges and questions on the horizon. Nevertheless, Lobo and Wallin were supremely confident, a hallmark of their attitudes toward past ventures. Lobo said, "I knew the opportunity was here before I came on board. Without it, I wouldn't be here. Smoke and I were also very thorough in the crafting of our strategy. We were very careful to remain fairly quiet until we were sure that we had our structure relatively secure. Beyond that, it's execution that will make or break this thing. And I know that our team has the ability to create something huge."

Smoke agreed as he paid the check and hurried out of the restaurant, into his car, and off to the Indianapolis airport for another flight to another city to meet with another potential customer. This time it was a prominent supplier of a large and popular line of rums and other hard liquor products. As the flight taxied down the runway, Smoke found himself gazing out the window at a slate gray winter sky over the cold, windswept Indiana prairie and considering the formidable challenges that he faced. Where should he focus his efforts –

This case was written by Christopher R. Hunter (T00) and Professor M. Eric Johnson of the Tuck School of Business at Dartmouth College. It was written for class discussion and not to illustrate effective or ineffective management practices.

with suppliers, wholesalers, or retailers? Which group was going to be the main driver? How was he going to convince potential customers, whoever they were, that this new solution was going to result in efficiency gains and cost savings? Who was going to realize the greatest benefits from this product? For that matter, what were the benefits? While Smoke had thought through the answers to most of these questions, he thought it was important to think them through yet again and expand on them in preparation for his upcoming meeting.

Industry Overview

The $110 billion US alcohol-based beverage industry was almost evenly split with sales of wine and spirits accounting $51.4 billion of retail sales and beer filling the remainder. While the industry had experienced a general decline in volume sold, total revenues on a per case basis had increased since 1994, more than offsetting the decline attributable to lower volume. For example, the dollar amount reported from the sale of distilled spirits alone had increased from $29.9 billion in 1994 to $33.6 billion in 1997 while unit sales had declined. On the other hand, wine consumption had increased since 1993, both in unit and dollar value, as consumers purchased more wine of higher quality.

The government imposed distribution structure of alcohol-based beverages largely influenced the relationships between players within the industry. This structure and these relationships also strongly dictated operating and financing strategies. Since the repeal of Prohibition in 1933, the federal and state governments had regulated the sale of spirits, wine, and beer. Most states mandated a three-tier system: Tier 1 as suppliers and importers, Tier 2 as distributors and wholesalers, and Tier 3 as retailers. All products were required to pass through all three tiers before their eventual sale to the consumer. In many states, suppliers were forced to use a single wholesaler to distribute their products, effectively insulating wholesalers from competition.

States fell into two broad regulatory frameworks: control states and open states. *In control states,* the government controlled the distribution of product, the retail sale of product, or both. Wholesalers often played a very limited role in control states and retail competition was typically limited to service differentiation since prices were set by regulatory agencies. New Hampshire and Michigan were examples of control states. In New Hampshire, wine and beer were sold through a traditional three-tier system while higher alcohol content beverages were sold to consumers through state run outlets ("state stores"). In Michigan, independent retailers sold all alcohol-based beverages, yet for liquors the state retained title to goods from supplier until they reached the retailer and set retail prices. Certain concerns, such as NWS Michigan, were paid a (flat) handling fee for performing distribution operations. *In open states,* the wholesalers and retailers were privately owned businesses. Wholesaler's purchased goods from suppliers and sold them to retailers at prices determined by a (somewhat) competitive market. The amount of real competition varied by the product (beer, wine, and spirits) and the individual state regulations.

Finally, retailers fell into one of two categories: *On-premise* retailers were those retailers that sold beverages to be consumed at that location. These included restaurants, hotels, bars, etc. *Off-premise* retailers were those that sold beverage for consumption in locations other than those in which they are sold. These included package stores, grocery stores, and convenience stores. Traditionally, on-premise accounts had been viewed as the building areas for strong brands. Brand owners had devoted the majority of their marketing and promotion efforts to this channel, hoping to convert on-premise sales into demand for their products in off-premise outlets.

Challenges

The alcohol-based beverage industry was rife with inefficiencies and challenges, both through supply chain redundancies and lack of information across the supply chain. Much of this inefficiency could be traced back to the repeal of Prohibition with the 21st Amendment. For that point forward, each state created it own rules concerning the distribution and sale of alcohol beverages. The resulting regulations varied widely between states and even within states for different products (beer vs. wine vs. liquor). When Prohibition was repealed, the industry faced huge pent-up demand, necessitating a strong production focus. This production focus, a very "push-oriented" model, worked very well through 1979. Over this period, alcohol beverage consumption increased steadily and predictably. The industry's high volume point was reached in 1979 when the increase reversed and a steady decline in volume became evident.

Once volume began to decline, producers were forced to move to more of a marketing focus in an attempt to transform the market into a "pull model." However, industry structure prevented effective implementation of this focus. While not actively erecting barriers, the wholesaler tier acted as a passive barrier to the flow of information from retailer to producer and vice versa. Therefore, production strategy and market definition at the supplier tier occurred without detailed information. In fact, the information available to suppliers was often incorrect, incomplete, or out-of-date.

Not only did suppliers face the challenge of obtaining reliable market information to craft marketing plans, they also had little power to ensure that those marketing programs were fully implemented. To ensure proper implementation, effective two-way communication between suppliers and retailers was essential. However, because of the three-tier structure and fragmentation within the industry, it was difficult to achieve broad communication across the entire retail tier and even then much of the information was filtered through the wholesaler tier. Finally, suppliers had difficulty measuring the effectiveness of marketing programs they had implemented and were handicapped in making timely adjustments and modifications.

In addition to the three-tier structure created by law, the alcohol beverage industry was subject to several other limitations. First, credit to retailers was tightly controlled. In most states, payment was mandated within thirty days. In others, the transaction between distributor and retailer was "cash only." Distributors were also limited to marketing their products only in the states in which they were licensed and they were precluded from shipping products across state lines. These restrictions limited competition at the distributor level and created significant barriers to entry, resulting in a limited number of distributors in each market, usually two or three, and exclusive supplier-distributor relationships within each state.

Trends

Several trends were evident in the industry, many of which could impact the success or failure of eSkye. First, for some time there had been a trend toward *consolidation* at all levels of the industry. This trend had accelerated in recent years. For example, Grand Metropolitan and Guinness had recently merged to form a huge supplier (Diageo) of many different alcohol beverages. This creation signaled the beginning of a potentially dominant supplier in the market. Second, there was *increasing investment* in premium global brands among top brand owners. The creation of the Absolut brand was at the leading edge of this trend and served as a model for premium branding in the alcohol beverage industry. Third, the industry had seen *shifting responsibilities* from brand owners to distributors. This trend was also accelerating over time as brand owners expected greater information sharing and marketing expenditures from distributors. Finally, the industry was seeing the formation of regional and national partners between distributors and brand owners.

National Wine & Spirits Inc.

The genesis of the eSkye idea grew out of National Wine & Spirits Inc. (NWS), a large Indiana-based wholesaler. Wallin, the Executive Vice President and CFO of NWS, saw the opportunity clearly through his extensive involvement in the industry. NWS was the ninth largest distributor of wine and spirits in the United States, measured on a revenue basis. Most of the company’s operations were in Indiana (54% market share), Illinois (32% market share), and Michigan (59% market share). Spirits suppliers contracted exclusively to NWS were Diageo-UDV (Johnny Walker, Jose Cuervo, Smirnoff) which comprised 7.7% of NWS’ total revenues, Fortune Brands (Jim Beam, DeKuyper) which comprised 17.7% of the company’s revenues, and Seagram (Absolut, Chivas Regal, Crown Royal) which comprised 32.6% of the company’s revenues. NWS also distributed many of the world’s leading wines in Illinois and Indiana. These included Banfi Vintners (Riunite), Canandaigua (Alamaden, Inglenook), and Sebastiani. Spirits sales accounted for a much larger share of revenue than wines, 68.8% to 24.1%.

From 1994 through 1998, NWS’ total revenue increased from $396.4 million to $521.4 million. This represented a compound annual growth rate of 7.1%. NWS’ EBITDA increased from $6.6 million to $17.7 million, representing a CAGR of 28.0%. To achieve this performance, NWS successfully integrated several strategic acquisitions, actively developed new geographic markets, pursued new supplier and brand relationships, and implemented advanced product handling technology and proprietary information systems. NWS had its eye on expanding further and remaining one of the preeminent distributors of alcohol beverages in the United States. NWS was known throughout the industry as an active acquirer of other distributors, a technological innovator, and a logistics leader.

In 1997, NWS recognized the opportunity of the Internet for simplifying information flows and began to build an on-line sales system in-house. Eddie Kao, who later joined eSkye as Executive Vice President of Technology, spearheaded the effort. The system was designed to allow suppliers access to the NWS sales system. Basically, a supplier could access sales data for their own particular products but no others. The system was offered free of charge to suppliers and was created as a competitive advantage for NWS. In fact, the system was one of the most progressive in the nation at the time of its creation. However, data collection was limited to only those products distributed by NWS in those markets served by NWS (Illinois, Indiana, Michigan). While the idea had been discussed, the system had never been extended to include on-line ordering for retailers. Moreover, NWS struggled to build and maintain the system because the company had a difficult time keeping and retaining talented developers.

Wallin realized the potential of an expanded version of the original system. However, he realized that it could never reach its full potential as a part of NWS. The company would be unable to expand the system beyond a limited number of products in a limited number of areas without encountering resistance from suppliers and wholesalers outside of the NWS umbrella. Competing wholesalers and the suppliers represented by them would be unwilling to utilize a system which would essentially hand over their data to a competitor. A wholly independent entity was required. Hence, the creation of eSkye.

eSkye.com

Wallin and Lobo began crystallizing the eSkye.com strategy in March of 1999. At the time, Wallin was devoting the majority of his time to his role as Executive Vice President, CFO, and Director of NWS. Lobo was still working as Director of Human Capital and Planning for Coca-Cola Company in Atlanta, GA. With the help of a small group of angel investors who provided $1.7M in seed capital, eSkye separated its identity from NWS in July 1999 and Lobo joined as President of the new company. At the inception of the company, Dr. Kao also joined as Executive Vice President for Technology. eSkye was officially born.

Throughout the remainder of the summer, eSkye was faced with the dual challenge of creating the technology necessary to reach their goal of an on-line ordering solution for the alcohol beverage industry and finding customers willing to test the product in their own businesses. To feed their development, eSkye initiated a successful private placement round of $3.7M in September including investments from the Ingram family (Ingram Book and Ingram Micro) and other alcohol beverage distributors (e.g., R.S. Lipman Co. of Tennessee). Through previous relationships with on-premise retailers, eSkye was able to recruit a list of twenty-five retail customers to participate in a pilot program for the new systems. (See Exhibit 1 for a list of test clients.) These clients were located in NWS markets (Illinois, Indiana, Michigan) and were limited to products carried by NWS. eSkye completed its pilot program and announced its capabilities in a December 15 press release.

The pilot project served many purposes. First, it allowed eSkye to test the efficiency of their system, a patent pending system known as eBOTS™. This system was described as "an innovative e-procurement service for enhanced control and management of alcohol beverage purchasing." This system was the core of the eSkye offering. It was designed to seamlessly link the retailers, both on- and off-premise, along with distributors, and suppliers within the existing regulatory environment. It also allowed eSkye to plan for the scaling of the product, testing it first on a small group while planning for the implementation with a larger group. Second, the pilot provided time and forum for the training of customer account managers, known as CAMs.

The CAMs were supervised by Clay Wallin, Vice President of Operations for eSkye. Clay, the younger brother of Smoke, joined eSkye in July 1999 from his position as Logistics Services Engineer for Hewlett-Packard Company where he had been employed since 1997. Clay's goal was the assembly of a high quality list of independent test clients with which to train the first CAM hires. The CAMs were intended to serve many roles. First, they would be responsible for servicing clients on a day-to-day basis, fielding requests for technical support and basic help. Second, the initial CAM hires were charged with creating and documenting many of the processes and procedures established through the test program. Third, the initial seven CAMs were intended to be the trainers of future CAMs that would be hired as eSkye underwent rapid scaling.

Capabilities

eSkye's web-based services provided a consolidated ordering site and product information link for licensed beverage sellers. eSkye's stated Mission was "to be the e-commerce solution for the global alcohol beverage industry providing:

- A superior buyer-focused and neutral model
- Procurement solutions for all beverage alcohol as well as other supplies
- Supply chain efficiencies benefiting all three tiers
- Significant top-line growth driver
- Additional value-added web enabled services."

eSkye was created to benefit all tiers of the alcohol beverage industry. For retailers, eSkye provided a single, convenient and efficient ordering system that allowed them to:

- Place orders with multiple distributors on-line, promoting convenience, efficiency and broader product offerings.
- Create a customized order guide for each individual account, based upon previous ordering history, which reduced mistakes and simplified the ordering process.
- Track orders by distributor and quickly analyze their business.

For distributors, eSkye significantly improved the order management process, automatically taking orders from retailers and then transmitting those orders electronically to a distributor's order entry system, so distributors could focus on activities that increased the volume of their business. The system:

- Simplified new product and customer development, especially through promotions and market-based events.
- Accumulated valuable information on market offerings.
- Helped to identify key business opportunities and ensured customer satisfaction.

Finally, with no direct customer contact, suppliers had little access to trade information. Through eSkye, suppliers had a direct link to retail data, enabling them to:

- Develop and implement highly targeted advertising and marketing campaigns that reinforced the branding of products in a very brand-critical industry, while easily and quickly tracking the success of these initiatives. Theoretically, this targeting could reach down to the level of the individual account.
- Focus promotional services to meet customer needs by employing the power of real-time access to industry information, trends, and a vital communications link with retailers to better assess market conditions.
- Create a customized web site directly channeled to retailers, featuring information on product availability, promotion and marketing programs, new product introductions and announcements.

Revenue

Through weeks of brainstorming, Smoke's team had identified four revenue strategies for eSkye. First, eSkye offered a entirely new marketing vehicle for suppliers. Typically, less than 50% of point-of-sale promotions actually reached the retail level. Most was absorbed or diluted at the wholesale level. Marketing communications were also very inefficient. Most of communications were in the form of volumeous printed material that reached the wholesale salesperson, but were not effectively transmitted to the retail tier. eSkye believed they were creating an entirely new channel for advertising. Much of this could occur in the form of specific account sponsorships. For example, a supplier could target a specific account (such as a Mexican restaurant chain), for a specific product (tequilas) based on very specific marketing information from that account (caterers to an upscale demographic that favors high margin products). The supplier could easily identify accounts that met certain criteria and target those accounts only.

Second, eSkye hoped to sell product demand data to the suppliers. With its role as an "Infomediary," eSkye could compile and distill market data that had not been previously available. Smoke was convinced that suppliers would pay for this syndicated data. The operational challenge for eSkye was to successfully collect, warehouse, and package this data in a usable manner.

Third, distributors were charged for each retailer order. Initially, eSkye set that fee at $.40 per invoice, regardless of the size of order. This cost was far below the cost incurred by a distributor to capture an order via phone, fax, or through an on-site sales representative.

Lastly, eSkye believed that they could create a suite of value-added services to bundle with their on-line ordering service. Potential service candidates for future offerings included:

- *Auction services:* eSkye planed to provide a market mechanism for the industry to allocate certain products of limited supply and to liquidate excess inventories efficiently.
- *Additional category supply source:* eSkye planned to leverage its experience in the alcohol beverage industry and extend the system to include a broader array of products and services, possibly including food and supplies.
- *Information link:* There are numerous trade magazines in the alcohol and food service industries, such as Cheers, Bartender Magazine, Kennedy's Newsletter, Wine Spectator, etc. eSkye believed it could become the single source for information related to the industry through both partnerships with these sources and through creation of its own content.
- *Brokerage and sales representation:* Many smaller brand owners and larger brand owners with new brands had trouble getting adequate representation across the U.S. eSkye believed it could provide selling opportunities at a fraction of the cost of paying a broker or other sales agent.

Wholesaler Perspective

While wholesalers were the central and most crucial factor to the success of eSkye, they realized the most intangible benefits from the system. Besides the direct benefits for reduced order entry cost, eSkye's sales strategy was to leverage interest from the suppliers and retailers to entice wholesalers to join the eSkye network. Smoke believed that suppliers would pressure wholesales to join the network because of the tremendous value of information that suppliers would receive from complete coverage of the industry. He further believed that retailers would also pressure wholesalers to supply an on-line ordering system. Within a market, wholesalers embracing the eSkye system would presumably be viewed more favorably by retailers than those who still required manual ordering through on-site sales representatives.

Of all three tiers, wholesales had the most concerns about the effect of the system on their position within the supply chain. Wholesalers traditionally maintained a tight grip on the information they gathered, viewing such information as proprietary and critical to maintaining their identity in the market. eSkye had the potential of destroying this identity as a retailer ordered product, not by distributor, but rather across the industry. To counteract this fear, eSkye emphasized the maintenance of wholesaler identity through links and customized web sites. However, wholesalers were still concerned that eSkye would inevitability cause brand erosion. Wholesalers had long seen their business as a service and relationship business and many were leery of anything that would change long-standing relationships. They were particularly protective of the relationships they had developed with certain customers, particularly large accounts. In fact, change itself was often viewed as a negative and wholesalers were concerned with eSkye's somewhat cavalier attitude toward the ease and inevitability of change.

Competition

eSkye's faced two types of competition: web-ordering schemes developed by other distributors and other independent start-up firms. While there were several Internet startups working in the B2C space (such as wineshopper.com) the only significant effort in B2B was BevAccess.com. On it's web page (www.BevAccess.com), BevAccess declared:

> BevAccess.com is the first Industry Exchange for the alcohol beverage trade, which provides wholesale buyers and sellers with fast, easy centralized ordering, detailed information, and highly targeted advertising. BevAccess.com's proprietary e-commerce technology dramatically increases operational efficiency, providing immediate financial reward.

- We focus on technology solutions for the trade.
- We deliver time and cost savings to Buyers, Sellers, and Advertisers.
- We offer all categories of alcohol beverage: wine, liquor, and beer.
- We make online ordering transactions easy to execute and user-friendly.
- We provide detailed industry information for research, training and education.
- Our technology increases your effectiveness, saving you time, money and resources.
- We have answers for every question—when you need us—by phone, e-mail, and online.
- You don't have to wait. Register now and get a ready-made platform to conduct business-to-business e-commerce today."

Founded by two recent graduates from Cornell's hotel administration program who had little liquor industry experience, BevAccess was formed 6 months before eSkye. BevAccess had staked its success on its relationships with on-premise sector of the retail tier. This strategy differed from eSkye that was leveraging relationships with wholesalers and suppliers. Wallin felt that eSkye had stronger industry relationships and had assembled a more comprehensive and credible team. Moreover, Wallin believed that eSkye had technological advantages with a more stable and scaleable web platform.

January 2000

As January rushed by, eSkye was in the process of migrating from a test environment to a live environment. Over the course of the next few months, eSkye planned to roll out its offering throughout Illinois and Indiana. To launch and test its systems, eSkye was leveraging its relationship with NWS Illinois. Basically, eSkye was utilizing NWS' Illinois sales force to drive penetration in the market. The sales force was charged with getting placement in as many accounts as possible. Duane Williams, Vice President of Business Development, remarked:

> We have to move quickly to gain penetration in the market. Success in Illinois will go a long way to creating success in other states. We have to move quickly, though, before wholesalers begin creating their own home grown systems. While these systems, by their nature, will be less comprehensive and will only serve segments of the markets covered by those particular wholesalers, it will be difficult to supplant them once they have been installed. Wholesalers will become attached to the systems they have created despite the opportunity to have a more comprehensive system through eSkye.

In addition, eSkye was quickly building momentum in control states. Control states were, in some ways, an easier arena to penetrate because of their more centralized nature. eSkye improved the states' effectiveness, in effect off-loading many of their responsibilities. Certain accounts in Michigan, a control state, were part of eSkye's initial test and Michigan was to become one of the first live arenas for the eSkye system.

In addition, eSkye had secured approval from the New Hampshire State Liquor Commission to launch a pilot program providing on-premise national retail accounts throughout the state to access the eSkye system. According to John Byrne, Chairman of the New Hampshire State Liquor Commission, "eSkye's online alcohol beverage ordering system offers our food service and hospitality businesses convenience, cost efficiency and speed. With eSkye, they can spend much less time ordering and more time ensuring that visitors to the state have the kind of experience that brings them back to New Hampshire again and again." eSkye was working hard to secure similar contracts in other control states such as Pennsylvania.

eSkye was also in the process of making in-road into open states. On February 2, eSkye announced that it had secured agreements with alcohol beverage wholesalers National Distributing Company, Magnolia Marketing, Republic Beverage, Block Distributing, The Wirtz Corporation, and Empire Distributing. (See Exhibit 2 for list of largest U.S. distributors). These agreements would expand eSkye beyond Michigan, Illinois, Indiana, and New Hampshire into Arizona, Colorado, Florida, Georgia, Iowa, Louisiana, Maryland, Minnesota, Nevada, New Mexico, North Carolina, South Carolina, Texas, Virginia, Wisconsin, and the District of Columbia. Wallin said,

> These new partnerships take eSkye into a whole new level of market penetration and industry acceptance. We are now active in setting up pilots

as well as full launches in 19 states which gives us critical mass of coverage that will allow our national account customers to realize the full benefits of the eSkye system. These partnerships give us the traction in the industry necessary to be successful.

Discussion Questions

1. How does eSkye's ordering concept for the alcohol-based beverage industry change both the flow of information and the role of the supply chain partners?
2. How would wide adoption of eSyke's web-ordering scheme change the power structure within the supply chain?
3. The alcohol-based beverage industry is an old and heavily regulated industry where relationships and legislated three-tier distribution has allowed the supply chain to remain very inefficient. If a web-based ordering system can be successful here, how will the web impact your industry?

Exhibit 1:eSkye.com Test Clients

- Lettuce Entertain You – Chain of Chicago restaurants
- InterContinental Hotels
- Rain Forest Café
- Food & Drink – Group of Chicago Taverns
- United Liquors (Archer Liquors) – Chicago liquor store buying group
- Armenetti - Chicago liquor store buying group
- Max & Ray's - Chicago liquor store buying group
- The Palace at Auburn Hills
- 18 others

Exhibit 2: Top U.S. wine and spirits wholesalers

1. Southern Wine & Spirits of America	$2.82 billion
2. Charmer Industries/Sunbelt Beverage	$1.575 billion
3. National Distributing	$1.37 billion
4. Young's Market Co.	$1.09 billion
5. Glazer's Wholesale Distributors	$1.085 billion
6. Wirtz Corp.	$660 million
7. Peerless Importers	$625 million
8. Johnson Brothers Wholesale Liquor Co.	$550 million
9. National Wine & Spirits, Inc.	$544 million
10. Republic Beverage	$425 million