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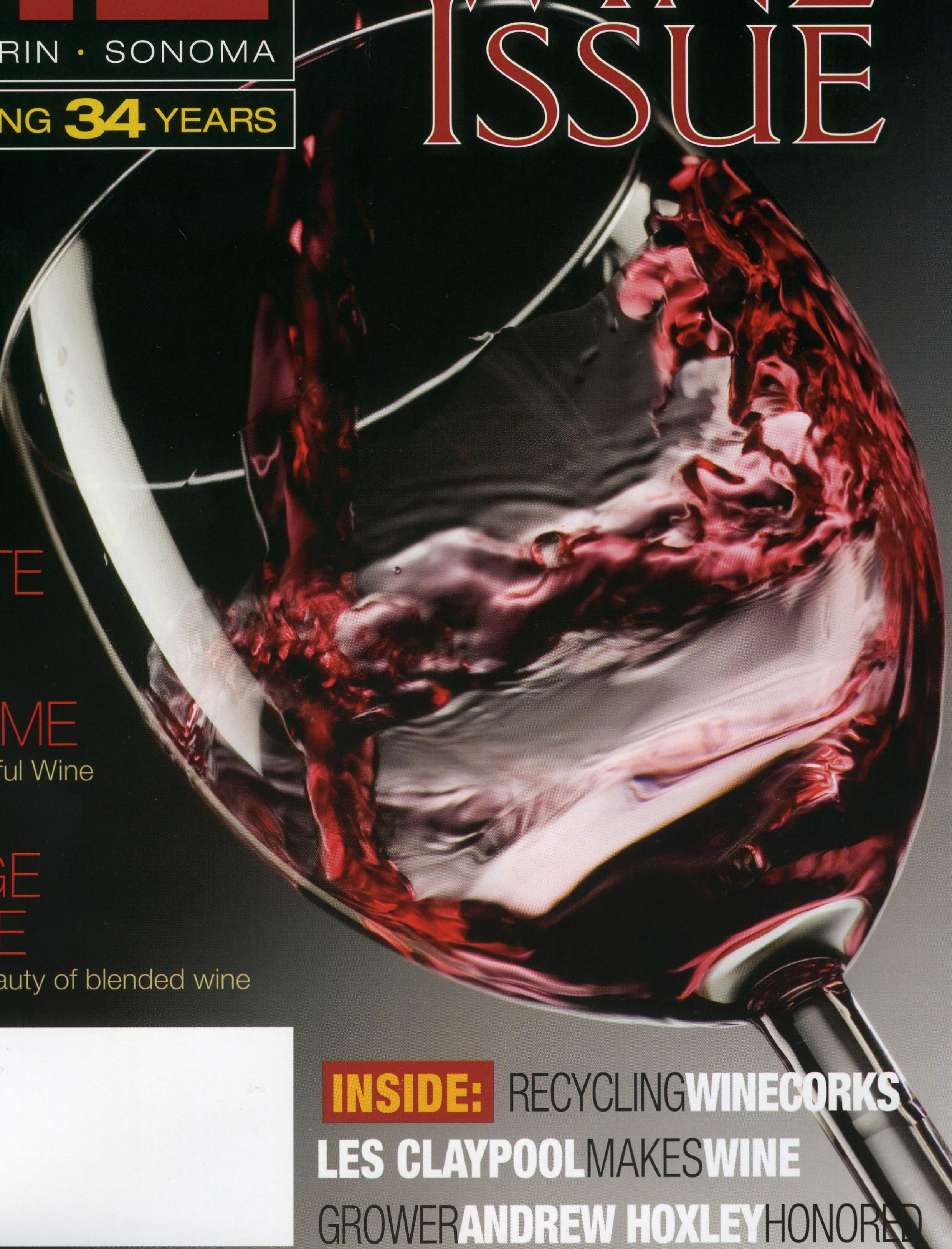

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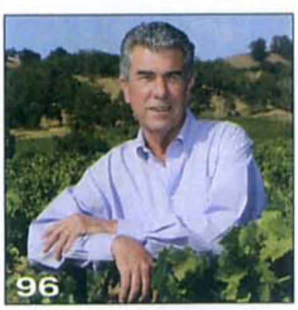

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SEEKING FU

New Vine's expansive storage warehouse [Photo courtesy of Wark Communications]

LFILLMENT

Third-party direct wine shippers are helping wineries increase sales—a trend that only promises to grow.

By Patricia Dines

The sudden closing of New Vine, Napa's pioneering direct wine shipping operation, was big news last May in the wine industry and beyond—generating uncertainty, rumors and ripples of concern. The intrigue only increased when Napa's Inertia Beverage Group (IBG) offered a financial lifeline, then eventually purchased New Vine's assets. Beyond the drama, these events offered a peek behind the scenes at the innovative businesses providing nuts-and-bolts logistics for the growing direct wine sales market.

"We're not the glamorous part of the wine industry," explains Truman Reynolds, general manager of Windsor's Pack n' Ship Direct. "It's not the vineyard and the nice winery that everybody comes out and says, 'Gee, I wish I lived here.' We're the logistics part of it. We store it, are custodians of it, move it through the retail and wholesale channels. It's not a high-margin business, but it's something wineries need."

"The people who made money in the gold rush are the ones who sold the pans and shovels," advises Barbara Insel, industry analyst and president/CEO of Napa's Stonebridge Research Group. "In most industries, it's the people who provide the innards of it who really have the stable businesses. And you really can't modernize an industry until you have those innards. But you need a certain amount of scale to make it happen, and that's hard to do in an industry of small-scale players."

The wine distribution bottleneck

Until the mid-1980s, direct shipping of wine in the United States was severely limited because of restrictions dating back to Prohibition. As a result, nearly all wine was sold through a three-tier system, traveling from wholesalers to retailers to consumers. Even today, Insel estimates, about 90 percent of domestic wine goes through this system.

Tom Wark, principal of Wark Communications

According to Tom Wark, IBG spokesman and principal of Wark Communications, "The traditional three-tier system is [like] an hourglass, with wineries at the top, feeding hundreds of thousands of products through a very narrow channel controlled by wine distributors." At the bottom are hundreds of thousands of retailers, restaurants and consumers seeking products. However, because of the large number of different wine products (or SKUs), plus wine's slow turnover rate (and, thus, inventory cost), wholesalers only carry a small percentage of the available wine labels.

"That's why, no matter what grocery store you go into in the United States, you normally see roughly the same 200 wines. It's really hard to get into the wholesale chain," observes Josh Langford, New Vine's former vice president of sales and marketing. "There are about 250,000 SKUs available worldwide," he adds, but "about 80 percent of the revenue is made up from the top 250 SKUs." Last fall's economic downturn further reduced the number of labels in the channel.

"It doesn't make sense for most wineries to do their own fulfillment. It's just not an efficient use of time and resources."

—Barbara Insel, Stonebridge Research Group

Selling direct

This situation has increased wineries' interest in selling directly to consumers through tasting rooms, wine clubs, the Internet, mail order and phone sales. IBG President/CEO Ted Jansen calls direct sales "the most profitable path for wineries to gain market access, increase sales, protect their brands and create margin opportunities." He describes an IBG customer whose direct sales generated about 20 percent of its transactions—but more than 50 percent of its revenue, because of the higher margins.

While Jansen and his staff often hear about customers' "struggles trying to sell their wine in a system that simply isn't

Barbara Insel is president/CEO of Stonebridge Research Group in Napa.

looking to take on any more brands," he emphasizes, "we don't see [direct sales] as a substitute for three-tier, but a complement to it."

One factor increasing the opportunities for direct sales has been the wine industry's success in loosening state shipping restrictions. Twenty years ago, only four states allowed shipments from out-of-state wineries directly to consumers, according to Napa's Free the Grapes coalition (*http://freethegrapes.org*). Now, 45 states allow such shipments from wineries through various methods, although only 12 let retailers do the same. While the situation has improved, a complex patchwork quilt of laws remains. "The wine industry is very complex, especially for as simple as it *ought* to be," sighs New Vine's Langford.

Stepping in to help wineries navigate these laws are third-party logistics companies, which have created technology and services for direct shipping to both consumers and "the trade" (retailers and restaurants).

It was this vision of helping wineries sell directly to consumers by overcoming complex state regulations that led to the 2001 founding of New Vine Logistics (renamed New Vine in February 2008). Katie Hoertkorn, New Vine's founder and former president/CEO, explains, "The whole objective was to let wineries concentrate on sales and marketing, versus the back-end processes."

"It doesn't make sense for most wineries to do their own fulfillment," counsels Insel. "It's just not an efficient use of time and resources. Logistics is an economy of scale business, [which gets cheaper with greater volume] because there are so many fixed costs."

Direct wine sales got a notable boost when the landmark 2005 Supreme Court Granholm decision opened up new markets for interstate shipping. From 2005 to 2006, according to Insel, sales grew 28 percent, followed by a 31 percent increase in 2007 as new markets opened up. Growth fell back to 7 percent in 2008, largely because of the economy's downturn in the last quarter. Insel estimates domestic direct wine sales were $3.2 billion in 2008, about one-tenth of the estimated $30 billion in total domestic sales.

New Vine's journey

Hoertkorn's innovation in the wine industry was inspired by her work for international shipping company DHL from 1984 to 1999, including running DHL's global logistics group. DHL developed methods and technical tools for overcoming international shipping barriers, thus significantly expanding the types of items that could be shipped while trimming costs and transit time. Hoertkorn saw an opportunity to similarly serve the wine industry.

In 1999, she went to work for *Wineshopper.com*, leading the team that built its logistics back end, including a groundbreaking system for moving individual wine orders directly to consumers through the three-tier network, "in an automated, auditable and economical transaction." After that company merged with the (old) *Wine.com*, which then went bankrupt, Hoertkorn acquired the fulfillment center and the back-end software as the foundation

Katie Hoertkorn founded New Vine in 2001.

for New Vine Logistics.

New Vine then expanded and refined these systems, building an extensive, industry-leading three-tier network with a complete audit trail; creating a massive, 150,000-square-foot, fully automated, paperless fulfillment center; and pioneering other solutions, such as temperature-controlled packaging. IBG's Wark praises New Vine's "cutting-edge logistics, shipping and compliance capabilities," and calls its warehouse "a stunning piece of engineering."

At its peak last year, New Vine's 120 employees served 200 customers, primarily wineries, including names such as Beringer and Chateau St. Jean. They stored 1.6 million wine bottles in inventory, moved about $200 million in wine annually, shipped to customers in 44 states and, according to a June 1, 2009 article in the *Press Democrat*, earned $30 million in revenues in 2008. Hoertkorn calls both Wineshopper and New Vine "absolutely revolutionary," because they "allowed the 21st Amendment [which repealed Prohibition] to function in the Internet world."

Trouble brews

This past June, New Vine's next level of achievement was finally about to occur. E-commerce giant *Amazon.com* had contracted with the company to do the back-end logistics for its upcoming wine website, and, after months of preparation and investments in production expansion, the website was quietly in the final testing phase, with test orders being run and the site ready to launch.

Then came the bad news: At the last minute, New Vine's expected (and much-needed) financing had fallen through, which then froze New Vine's bank accounts. The company couldn't meet payroll, explains Hoertkorn, so by law it had to send its employees home. A sign on the company's door read, "We regret to inform you that New Vine is in a state of financial crisis and has been forced to cease operations." Through its voicemail and emails to clients, New Vine indicated it was "no longer receiving or shipping orders from our facility."

With such little notice, and the annual Napa Wine Auction starting the following week, mayhem ensued. Wineries worried about their inventory and pending orders; employees were anxious about getting paid; unknown numbers of customers jumped ship; and everyone wondered what had just happened to this industry leader on the brink of success.

"It literally happened in a 24-hour period," remembers Langford. "It's hard when you get told at 4 p.m. on Friday to release your employees, and then at 5 p.m., your customers start calling and asking, 'Hey, how come your website's down? How am I going to get my wine out?' We literally had people beating on our front door, showing up with trucks, and lots of voicemails and confusion."

Opinions abound regarding the cause of the company's collapse, but Hoertkorn attributes it to a combination of factors, led by the freeze in credit markets and followed by the ABC's scrutiny—and 10-year approval—of its "agent of the consumer" model, which delayed third-party compliance programs.

"We had a thriving, growing business," says Hoertkorn. "Last summer, when we started to go out for funding, we had a great reception," because the company had doubled its sales and revenue three years in a row and had just secured the Amazon contract. Once the financial crisis hit, though, "it was impossible to raise money," says Hoertkorn. "We just didn't have the reserves to weather the storm."

She muses, "It's sad…I put eight years of my life into this, with a dedicated team, so many hours. And we came very close…it's just what happens in business. If you don't have capital to grow your business, you run into a brick wall. You just have to go forward and make the best of everything."

Inertia steps in

With New Vine in limbo and facing possible shutdown, many welcomed the news a week later that IBG would provide funds to resume operations while exploring what to do next. IBG eventually bought New Vine's assets at auction on July 27 in a process that included its own share of controversy.

But why did IBG buy New Vine? Founded in 2002, IBG offers web tools that enable its approximately 300 clients to manage online sales direct to the consumer and the trade. In 2008, it released its integrated Rethink Compliance tool, which allowed compliance checks and reporting. Prior to its purchase of New Vine, IBG let other logistics and shipping companies integrate into its ecommerce software, the Rethink Engine.

"We were already on a path to build infrastructure as part of our business model," says IBG's Jansen. "But that takes time. Acquiring New Vine simply lets us do it quicker."

Jansen sees the purchase of New Vine as "the start of an exciting new phase in our company's evolution. We're now the only company in the industry that has all the necessary components for a winery to sell direct under one roof." This includes e-commerce technologies for consumer purchases, fulfillment and logistics to get the wine to the consumer, and compliance to make sure wineries are following each state's differing regulations. Already, he says, IBG's winery clients are seeing value in the new arrangement.

When asked about the future of the lucrative Amazon contract, Jansen indicates they've had "productive" conversations but don't have an agreement yet. "The first priority is integrating operations and managing the business so that New Vine clients see no interruption in service," he says.

Hoertkorn concludes that, while she's disappointed by New Vine's downfall, she's glad IBG could step in, both to "take care of the customers" and to carry forward the facility and systems they'd created. She adds, "I passionately believe in the solutions New Vine developed…[and] I'm glad that there was some outcome other than nothing."

The future

This major shakeup at New Vine also impacts the fulfillment field's other key leader, Napa-based Wine Tasting Network (WTN), which serves more than 100 wineries. Last year, WTN caught up with New Vine's share of the logistics market, according to Insel, with each capturing about 15 percent of sales.

Chris Edwards, VP/GM of WTN Services, estimates the consumer direct fulfillment and compliance market currently grosses about $500 million annually. He sees the arena as "pretty fragmented right now," with a few bigger companies, many small players and a lot of shipping being done by wineries in-house.

But he also notices wineries migrating to third-party fulfillers, as evidenced by the increasing number of providers over the past 10 years, from about three to probably 20 now in Northern California. He believes "the [fulfillers] that can afford to implement the technology and take a long-term view will likely win the market space."

IBG's Wark sees growth potential in direct consumer wine sales as well. "I wouldn't want to predict the economy, but I think that, a decade from now, we'll be seeing double the amount of direct consumer sales that we see now, because consumers are becoming accustomed to doing their own research and going online to buy things. And I think we'll see many more states open their borders for retailer-to-consumer [interstate] shipping." Driving these changes, he predicts, will be consumers upset that they can't order the wine they want, and states looking for additional revenue sources.

Insel also sees room for growth in direct sales, both from states opening up and consumers seeking more variety in their wine options. She says established retailers with online stores currently dominate wine e-commerce, because they offer both trusted guidance and the brand variety that consumers value. Significant growth in wine e-commerce from other sources will depend on a major, well-known online retailer, such as Amazon, entering the market. Still, she advises, "distributors will always play a major role. The three-tier system is not disappearing."

Much is yet to be determined about how the emerging wine logistics industry will evolve, including how the players will organize themselves to meet customer needs. "We're going to be moving into the holiday season pretty soon," notes Reynolds, "which is the largest volume time of the year" and will likely test the new configurations. Beyond that, only the future knows for sure. ■

Please email comments to editor@northbaybiz.com

Glossary of Key Direct Wine Shipping Services

STORAGE
Storing a winery's cases in secure, temperature-controlled conditions, with tools to manage inventory and related services. Reynolds indicates that, "generally, the [winery's] property is too valuable to build a big warehouse there to store case goods."

COMPLIANCE
Navigating the patchwork of state regulations to ensure a winery is operating legally in each state. According to Jansen, "that can involve everything from up-front permitting and label registration, to making sure the licensee can actually order wine legally" and verifying a consumer's age or status with volume limits. "Then, on the back end, it provides all the mechanisms to file reports and taxes in the state."

FULFILLMENT AND SHIPPING
Receiving the customer's order, doing a "pick and pack" of the bottles from the winery's inventory in the warehouse and shipping it to the customer—hopefully all at an attractive cost and in a reasonable time, while protecting the wine in transit.