

Automatic MERCHANTISER



**Detroit duo
thinks outside
the machine**

What drives your business: market or operations?

By Elliot Maras, Editor



Read this month's cover story on Sterling Services very carefully.

This is the second profile we have done on an operator that uses a fully-automated, self checkout market. (The first such profile was in the November 2006 issue.)

This fully-automated, self checkout market uses radio frequency identification (RFID), a technology which is bringing new efficiencies to many industries. This particular product addresses the biggest single challenge that the automatic merchandising industry faces – improving customer value.

The owners of Canton, Mich.-based Sterling Services astutely note that the system gives them a way to address the main barriers to success in today's vending market: the lack of vend product variety, the need for multiple payment options, and low perceived consumer value.

FIRST QUESTION: RELIABILITY

The first question any intelligent operator asks about new technology is how reliable it is. Based on performance to date, this fully-automated, self checkout market makes the grade.

That's the easy question. The hard one is where this new solution fits into the existing automatic merchandising landscape. Here

is where our industry must better understand itself.

Will *Automatic Merchandiser* readers adopt new solutions to meet the challenges they face?

Veteran operators have already realized that the world of their fathers is fading fast into the history books. The traditional vending service delivery model cannot meet the needs of today's consumer in as cost efficient a manner as it once did. New delivery models are needed.

WILL VENDORS USE NEW MODELS?

Rob Simmons, whose company supplies the fully-automated, self checkout solution that Sterling Services uses, notes that most of the systems installed to date are "self ops." Out of 16 installations that presently exist, more than half are in locations that also have vending but are not operated by the vending service provider.

Are vending operators missing the boat? The answer to that question depends on how operators view their role in today's marketplace.

Simmons fashions the question as follows: Is your business "market driven" or "operations driven"? This question has been posed many times in recent years, especially by advocates of category management. It is a serious

question vending operators need to ask themselves.

"If the market defines them (vending operators), then we (the fully-automated, self checkout market) are a huge opportunity for them," Simmons says.

On the other hand, if operations defines the business, Simmons says, he has little to offer the vending operator.

CHANGE WON'T BE EASY

New solutions such as this require some adjustments to the existing vending operation. The business must develop relationships with new suppliers and must incorporate some new operating procedures. It can seem overwhelming.

The operator must begin with an understanding of his or her business purpose.

Is it to serve the location manager who wants to provide a better service to his clientele and to the end user who wants a better value?

Or is it to fit into an existing way of doing things?

Simmons is clear about his role. "It's about service you are able to provide people," he states. "It's about the passion to serve. I don't think it's about us. It's about what people want."

So what is your role? | ◀



Sterling Services has become leader in a competitive market thanks to a visionary approach: restaurant quality foodservice and a self-serve kiosk that provides more convenient shopping.

By Elliot Maras, Editor

One thing that strikes you when you visit the headquarters of Sterling Services Inc. in Canton, Mich. is that the company has class. The building may be in an industrial park, but the interior is classy. The rooms are furnished with stylish, contemporary furniture, everything is neat, and the walls are adorned with prints by the famous photographer Ansel Adams, Picasso and others.

It's the type of environment you would expect from a company that caters to customers that want a high class service. And that's the message that owners Ray Friedrich and Chris Peppo want to convey.

Businesses today want top value for their money, and Friedrich and Peppo aim to provide it. Sterling Services, founded in 1986 when the partners were nearly fresh out of

high school, offers state-of-the-art vending, contract foodservice, catering and an unattended convenience store called “Fast Track Convenience.”

Building a successful vending/foodservice operation in Greater Detroit is no small accomplishment, given the high caliber competition and the struggling local economy.

A veteran vending operator might have advised Friedrich and Peppo to try their luck elsewhere when they decided to get into vending, but the youthful duo simply didn’t know any better. They were merely following their hearts’ desires.

BEGINNING AT THE BOTTOM POSITIONS IN FOODSERVICE

Upon graduation from high school, both men worked in restaurants. They loved the restaurant business and wanted to go into business for themselves. They didn’t have a lot of capital, so they kept a close watch for any and every opportunity to get into foodservice. When a new hotel opened in one of the suburbs, they approached the general manager and asked if they could do the hotel’s catering.

They didn’t get the catering gig, but when they were visiting the hotel, they noticed a proposal from a vending company to lease vending machines. They thought the company was charging a hefty price for the machines, and told the manager they were sure they could do a better job.

The hotel manager agreed, and the youthful duo found themselves in the vending business.

VENDING OFFERS A LOW-COST ENTRY INTO FOODSERVICE

Friedrich, not knowing much about vending, called some local vending operators to learn what he needed to do. He studied vending banks to get an idea what products to buy and how to price them.

With their collective savings of \$1,500, they bought a snack machine from a local equipment distributor and leased a beverage machine from a bottler.

The new snack machine had a bill validator, which was new at the time and proved popular. The front desk at the hotel was often strapped for change for the machine. “Dollar acceptance was something they liked,” Friedrich said.

The hotel turned a good business, and, keeping their day jobs and working out of Peppo’s parents’ garage, the duo went out and signed up six more hotels that year. They provided meter readings along with the commission payments, something most vending companies weren’t doing. Their first year’s sales totaled \$53,000.

They quickly realized that a lot of vending companies were promising locations commissions that seemed unrealistic. They also realized that those same vending companies weren’t providing meter readings. Hence, they made it a point to tell customers that they provided meter readings as a way to verify the commissions.

STARTING OUT IN HOSPITALITY ACCOUNTS

“Detroit was full of companies offering unrealistic commissions,” Friedrich said. To compete against these operators, he told the customers he would guarantee a certain dollar commission that would at least match what the competitor could offer, even if the competitor was offering a higher percentage.

Working mainly with hotels that first year gave Friedrich and Peppo a broad exposure to the vending business. One hotel did not have any restaurants nearby and asked for a fresh food machine. They bought a used food machine and stocked it with precooked, frozen food.

BILL ACCEPTORS HELPED WIN BUSINESS

Friedrich and Peppo kept their regular jobs for three and a half years as they sought more vending accounts. Buying new equipment with manufacturer financing, they were able to offer bill validators, which many of the competitors’ machines didn’t have. “It was easy for us to have the new technology because we didn’t have any old technology,” Friedrich said.

They were also quick to use large size snacks (LSS), which were being introduced in the late 1980s. LSS products were more successful in retail accounts, which dominated Friedrich’s and Peppo’s business at the time, and they yielded higher sales. Friedrich and Peppo allocated all facings to LSS in public locations and the top two shelves in other sites. “As soon as the large package size came along, we jumped right on it,” Peppo said.

They hired their first employee – a driver – six months before they themselves quit their regular jobs. By that time, they had expanded from hotels to a few car dealerships for a total of 10 locations. Hiring that first driver was a milestone, as it was a lesson in the need to delegate, which is necessary for any business to grow.

One reason they were able to grow during a recessionary period is they weren’t targeting manufacturing accounts, which were suffering the most.

EARLY PARTNERS: VENDING MANAGEMENT FIRMS

Being involved with retail accounts, Friedrich and Peppo found it necessary to work with vending management companies. And being industry outsiders, they did not hold the established vending operator resentment towards management companies, which proved to their advantage.

Vending management companies liked Friedrich’s and Peppo’s practice of providing customers with meter readings. The management companies helped them get new accounts and enabled them to grow the business quicker.

Where many operators view management companies as meddlers in their relations with locations, Friedrich and Peppo took the opposite view. “You’re not at the whim of a rogue (location) manager,” Friedrich said.

One management company was especially helpful to them.

Charles Hoke, a veteran vending operator who operated a management company, was impressed with Friedrich's and Peppo's sales at a hotel account. Hoke, who was also an accountant, said they achieved higher sales than other operators he worked with. "We consequently got all the Red Roof Inns," Friedrich said. "This was as they (Red Roof Inns) were getting some good growth."

Hoke took a special interest in them and helped them with their financial management. "He is one of my mentors," Friedrich said of Hoke. Hoke taught them how to operate each route on a profit and loss basis.

Hoke also helped them set up a retirement plan for employees, and assisted them in selecting their first management software system.

Hoke eventually became their chief financial officer on a retainer basis.

THE ACCOUNT BASE DIVERSIFIES

Five years after launching the business, Friedrich and Peppo rented a warehouse and expanded to other types of accounts, such as business and industry, health care and schools. "We knew we had to diversify the client base," Friedrich said.

To serve manufacturing accounts, they needed to have more food machines and bigger vehicles with cooler and frozen compartments to deliver a broader merchandise assortment.

While the duo was quick to recognize the importance of having high quality food, they never wanted to operate a commissary. They believe in relying on specialists to perform this function. "If you're not going to be really good at it, don't do it," Friedrich said.

20-OUNCE BOTTLES DRIVE GROWTH

The introduction of 20-ounce beverages in the early and mid 1990s gave another impetus to growth. Sterling Services' focus on retail accounts made it easier for them to convert to 20-ounce than some other operators, but they



Charles Hoke, a veteran vending operator and vending management executive, is semi retired and acts as Sterling Services' chief financial officer on a retainer basis. Besides helping with financial management, he has been helpful with acquisitions.

also faced initial resistance to this change from their drivers. When drivers realized they could make more money, however, they became supportive.

Friedrich and Peppo converted all can machines to 20-ounce bottle machines in one year. As glassfront beverage machines became available, that, too, brought growth.

The bottles also made it easier to raise prices, they noted. "We got to rewrite the deal without having to go out to bid. It was a great opportunity," Friedrich said.

Glassfront frozen food/ice cream was another innovation that led to new growth.

Initially, Friedrich and Peppo utilized an ice cream subcontractor for ice cream. When Automatic Products introduced its glassfront frozen machine, they asked their subcontractor to use it, and when he refused, they decided it was time to get into the frozen machine business. "That's a big investment in infrastructure, but you add revenue. It didn't cannibalize anything else," Friedrich said. They offer both ice cream and frozen food in these machines.

GROWTH BY ACQUISITION

As the company grew, Friedrich and Peppo faced the challenge that many growing companies face; fewer available locations. They realized that acquisition offered a good way to grow. In 2000, they made their first acquisition, HAV in Southfield, Mich. They were able to improve the density of their routes.

The hardest part of the acquisition was getting the new employees to accept new ways of doing things. Sterling Services pays drivers on commission, and also uses planograms for beverage and snack machines that mandate most of the facings.

TECHNOLOGY BRINGS BENEFITS BUT ALSO RAISES QUESTIONS

Friedrich and Peppo also kept an eye on the increasing benefits of vending software. They recognized the impor-



Sterling Services jumped on LSS snacks as soon as they came out. Route supervisor Dave Werth checks on a machine.

tance of using category management for managing their snack and beverage machines, and they have utilized these programs for designing their machine planograms.

They use handheld computers in their warehouse, but not on routes. They continue to rely on manual meter readings. “You spend money to collect the data, but does that translate into a benefit?” Friedrich asked.

As for cashless vending, they are using Debitex’s closed system in two captive locations, but they are not ready to expand into “open” systems with credit card readers. “As that technology gets less expensive and more cost effective to deploy, that’s a real good thing,” Friedrich said.

And while they are pioneering new technology with their “Fast Track Convenience” initiative, they have yet to expand into remote machine monitoring. “We love information and technology, but nobody’s made a good enough argument to make the next leap,” said Friedrich.

NEED FOR NEW SERVICES ARISES

As the company grew, Friedrich and Peppo realized they needed to provide manual foodservice to win larger accounts. Even though both had spent years working in restaurants, they did not feel they had the expertise needed to provide a high quality foodservice program.

The partners spent a year researching contract foodservice. They visited cafeterias, queried corporate foodservice managers, and read foodservice trade publications.

They realized that the local contract foodservice market was saturated, even more than vending. There was no choice but to try to win customers from competitors.

They also knew that the leading complaint about existing services was “menu fatigue”; customers knew what to expect every day and were bored. “We’ve seen some incredibly ‘blah’ looking cafeterias,” Peppo said.

Their first step was to partner with foodservice operators. But in observing various companies, they did not feel they wanted to partner with any on a permanent basis; none of the companies they worked with was particularly outstanding.

The partners decided to hire a veteran corporate chef to establish their own foodservice program. In 2004, they approached Bakim Pellumbi, who brought 20 years experience as a restaurant chef. Pellumbi and his partner, Joe Hessling, operated a retail deli, Abe’s Deli, and did corporate catering. Pellumbi and Hessling signed on as partners in the company.

A RESTAURANT APPROACH TO ON-SITE FOODSERVICE

What distinguished Pellumbi from other chefs was not only the quality of the food, but bringing a restaurant approach to corporate dining.



Sterling Services provides bottled water in addition to vending. The company converted from cans to bottles in one year.

Friedrich and Peppo asked Pellumbi to develop signature brands. They came up with the name, “Global Cuisines.” “Global Cuisine is a very diversified entrees menu,” Friedrich said.

The basic idea behind “Global Cuisines” is to take a high-end approach to foodservice. “Our approach is truly different; we’re actually cooking,” Friedrich said.

Friedrich and Peppo operate most of their cafés on a profit and loss basis or on a subsidy basis.

Every day, the café offers a new theme. Every café has four to six employees under the direction of a chef. “We don’t operate cafeterias; we don’t like that word. We want restaurant quality food,” Friedrich said.

The café employees wear black jackets, and the prices are higher than in other manual foodservice sites.

Abe’s Deli is designed to bring a delicatessen concept to the workplace. The staff bakes its breads fresh daily, prepares soup from scratch, and offers premium meats and cheese and signature salads. “You can’t sell a deli sandwich using pre-sliced, institutional bread,” Friedrich said.

Friedrich said the high quality, cooked-from-scratch concept has been popularized by establishments such as Panera Bread. In the past 10 years, the U.S. consumer has become more discriminating in meal choices, which is why many of the fast food chains have moved to a stronger emphasis on quality over price. “You have to win them over every day,” Friedrich said.

WITH FOODSERVICE, QUALITY SELLS

“We find there is a huge pent-up demand for a quality foodservice,” Friedrich said. “It (the corporate cafeteria) tends to be a last resort for people. We wanted it to be the first choice. We didn’t have any preconceived notions about how it’s supposed to be done, just like in vending.”

In addition to the food, the company hired a graphic specialist to develop signage. The cafés also have high quality art work decorating the walls.

The menus are placed on the locations' Websites, and daily specials are e-mailed to employees by the employer. Menus are also posted in break areas.

A typical café will require an investment of close to \$10,000, Friedrich said.

IMAGE MAKEOVER BEGINS

The partners realized that to be seen as top quality food specialists, they needed an image to match. Their logo and marketing materials were fine for a vending company, but not a food contractor. Hence, in addition to the investment they made in product, equipment and salaries to establish a food program, they also hired a professional graphic designer.

The designer redesigned their logo, which is used on all their marketing materials, their trucks and their Website. This investment alone exceeded \$50,000.

"There's a big difference between marketing people, real graphics people, and printers," Friedrich said. "We're very happy with what they did."

Friedrich and Peppo realized they needed to expand their services to grow the company. This was the impetus for the contract foodservice. As busy as they were getting the new division organized, they kept their eyes open for other opportunities as well.

Little did they know in 2005 they would stumble upon another idea that would require even additional time and investment. An idea that would even further distinguish their company in metro Detroit.

2005: A NEW DIRECTION

At the 2005 National Automatic Merchandising Association Expo in Atlanta, Ga., they came across Freedom Shopping, a self-serve kiosk that uses radio frequency identification (RFID) technology.

The Freedom Shopping kiosk is outside of the realm of the traditional vending industry. While the booth attracted a fair amount of attention at the NAMA Expo, not many operators were willing to change their way of operating. But to Friedrich and Peppo, it was a no-brainer.

The duo recognized that the vending industry faces three major hurdles: the lack of products that can be vended, the need for multiple payment options, and low perceived consumer value. They were elated when they came across Freedom Shopping.

"This leapfrogs all of them (the three hurdles listed above)," stated Friedrich. "It's a single salvation to many ills. We're not in a commodity-based business any more."

As busy as they were launching their foodservice program, the duo did not hesitate to learn about Freedom Shopping. The system is made by Dagosi LLC in Hickory, N.C.



Ray Friedrich, left, and Chris Peppo wanted a foodservice that would bring an actual restaurant identity to a location.

The kiosk consists of a checkout station where products are scanned by an RFID reader. Products in the immediate area are displayed in baskets, racks or in refrigerated or frozen coolers.

To assist multiple purchases, all products are scanned simultaneously, unlike in a supermarket self checkout, where items must be individually scanned.

The customer selects items and takes them to the checkout area. An RFID reader beneath the touchscreen scans the RFID codes and lets the customer know the price of each item. The customer then authorizes the transaction on the touchscreen. The transaction takes six to 12 seconds. Customers receive a printed receipt.

Should the customer walk out of the immediate area with an unscanned product, the product's RFID tag signals the receiver, and an audible alarm goes off. The main office gets an e-mail alert. Management can review the surveillance video to see who it was.

The kiosk sends the data every 10 to 12 minutes to a password protected Website via a cable line, which also transmits the digital video images captured by the on-site surveillance cameras. The location needs to provide a dedicated, high-speed Internet connection.

FIRST FREEDOM SHOPPING ACCOUNT

After visiting Dagosi LLC and learning how the kiosk worked, Friedrich and Peppo pitched it to one of their largest locations. They convinced the location that the kiosk would better serve the employees than the vending machines.

They placed their first Freedom Shopping kiosk in an automotive parts manufacturer with 1,000 employees that also happens to have one of their manual feeding opera-

tions. This provided the advantage of having Sterling Services' employees on site in case location employees had questions about how to use the kiosk.

If a consumer has a problem and no one is there, a live help button on the touchscreen allows them to speak directly to someone at Sterling Services.

They had an employee spend a week at the kiosk to help instruct the location employees how to use it. There is also an instruction sheet posted on the wall.

The location employees are able to use cash, a credit card, an employee ID card, or a driver's license with a magnetic strip. To date, they have found that 70 percent use the ID card with the balance using the credit card.

Friedrich and Peppo said the kiosk offers twice the number of SKUs as the 15 vending machines did, and sales have doubled, averaging about \$1,000 per week. They noted that the upfront investment is about the same as a full bank of vending machines.

The key advantages are the pricing flexibility, being able to offer an assortment of packages, the customer's ability to touch the product prior to purchase, and the speed of purchase.

Friedrich said gum and mint sales in particular have been outstanding. "It's because (in vending) we can't sell package sizes like this and this is what consumers want," he said of the gum and mint offerings.

The system's Web-based software allows the company to review who bought what and when. There is also a real time inventory report.



Sterling Services paid a marketing company to redesign its logo to present a more professional image. The logo complements the decor in its cafes, along with other art work, to enhance the food presentation.



Friedrich and Peppo are able to sell merchandise in the Freedom Shopping kiosk that can't fit in vending machines.

In the future, they will introduce time-sensitive pricing. They can change the price remotely, over the Internet, or using a personal digital assistant.

Sterling Services sources many of the products for the kiosk at vending warehouses, foodservice warehouses, and Internet sources.

"This really offers a whole different aspect of retail," Peppo said.

In addition to consumable products, the kiosk offers over-the-counter medications, general merchandise, and greeting cards, which have been a big seller.

Some of the offerings include: \$1.69 for 3-ounce Bugles; \$1.89 for 2-liter soda; \$9.95 for an umbrella; \$9.95 for a camera; \$4.19 for a pint of ice cream; and \$3.50 for an energy drink.

They have found most customers are making multiple purchases.

The most labor intensive aspect of operating a kiosk is tagging the products with RFID tags. This is something that one of the company's warehouse employees does. The tags now cost about 13 cents apiece, and this is expected to decrease. At present, the cost for tagging and stocking represents about 10 percent of the product cost.

NUMEROUS ADVANTAGES OVER VENDING

"It's killing vending from a profit standpoint," Friedrich said of Freedom Shopping.

There are three video surveillance cameras in the room, which allow an employee at the company's headquarters to oversee it from a desktop computer in real time.

In the future, he thinks they will introduce kiosks to locations by providing employees with cards with some money loaded on them.

The kiosk is serviced by one of the company's regular vending routes.

Friedrich said the kiosk sales would even be higher if there were no foodservice operation in the vicinity. He thinks the ideal kiosk customer is one with 300 to 600 employees that has no cafeteria.

Friedrich also likes the fact that the skill level needed to service a kiosk is much less than that of a vending route driver. "You don't have to think to do this," he said.

While many observers see the kiosk as ideal for a public location, Friedrich prefers to use a captive location. "We have deterrence, but not theft protection," he said.

The duo are so excited about the kiosk, which they have named Fast Track Convenience, that they recently hired a public relations agency to promote it locally.



Mark Cross, vice president of sales, demonstrates the ease of self checkout at the Freedom Shopping kiosk.

Customer care: a dedicated focus



Steve Lininger and Brenda Murphy focus only on customer relations at Sterling Services.

Sterling Services has found having a dedicated customer care department critical to ensuring a high level of customer satisfaction. The company's customer care department consists of two employees who are responsible for visiting all locations, taking digital pictures of the machines, and meeting with the location managers.

Owners Ray Friedrich and Chris Peppo think customer care is too important just to delegate to sales people and route drivers.

"I always thought the relationship should be managed from the administrative side," Friedrich said. "It's key to retention for us, having customer care people."

The two customer care officers, Steve Lininger and Brenda Murphy, have specially designed customer care software, where they keep track of individual customer preferences.

"It makes our (driver) transitions very seamless," Friedrich noted.

ACQUISITION WILL FUEL GROWTH

In the meantime, the company looks to continue to expand its vending division, largely by acquisition. This allows not only greater route density, but a way to bring on good employees.

The company has an internal newsletter for its employees, and has a written employee manual. Employee evaluations are held regularly.

The future is promising for Sterling Services. They have begun to notice stronger customer acceptance recently for their "better for you" nutrition program, "Target Your Health." They credit this to the rising consumer understanding of nutrition and the fact that more products that meet these guidelines are now available to them.

The biggest challenge continues to be profitability. Since they have surpassed the \$10 million revenue mark, they believe they have the infrastructure in place to support continued, profitable growth. ▶

Profile: Sterling Services Inc.

HEADQUARTERS LOCATION: Canton Mich.

FOUNDED: 1986

OWNERS: Ray Friedrich and Chris Peppo

NUMBER OF ROUTES: 20

NUMBER OF EMPLOYEES: 78

BUSINESS MIX: Vending 80%, Foodservice/catering 20%

SOFTWARE PROVIDER: MEI

ANNUAL SALES: Not revealed