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The Home Depot, Inc.

The year 2007 started with a bang at the Atlanta, Georgia-based do-it-yourself home improvement chain the Home Depot, Inc. ("Home Depot"). With 364,400 employees, Home Depot was the largest specialty retailer in the U.S., and the second largest American retailer after Wal-Mart.[1] On January 3, 2007, Frank Blake took over as chairman and CEO, one day after former chairman and CEO Robert Nardelli's surprise resignation. A January 2 Board of Directors meeting had addressed the board's simmering discontent with the company's depressed share price despite improved revenues and profits under Nardelli. During the company's May 2006 annual meeting, the board had suggested that Nardelli's generous compensation package be tied to the company's share price, a proposal Nardelli had flatly rejected.[2] On January 2, 2007, Home Depot and Nardelli announced they had "mutually agreed" on Nardelli's immediate resignation.

Formerly a top executive of General Electric (GE) in charge of its Power Systems Division, Nardelli had arrived at Home Depot to considerable fanfare in December 2000 to take over for retiring founders Bernard Marcus and Arthur Blank. After years of rapid growth, Home Depot in 2000 was a $45.7 billion, 1,134 store home improvement retail chain.[3] (See **Exhibits 1** and **2** for Home Depot's financial data.) Nardelli set out to bring greater discipline to the sprawling retailer's operations, including merchandising and store management. He introduced cost-cutting measures at various levels, including centralizing purchasing and shifting from mostly full-time store staffing to depend on more flexible part-time contracts. By 2006 sales had shot up to $90.8 billion. Profits had more than doubled from 2000 to 2005 to $5.8 billion.[4] (See **Exhibit 2**.) Yet Home Depot's stagnant share price throughout Nardelli's tenure compared poorly with close competitor Lowe's, which saw soaring gains in its share price over the same period.[5] Furthermore, Nardelli's centralization had been criticized by employees, managers and customers as negatively affecting the quality of service and company morale and identity.[6]

As successor to Nardelli, Blake faced significant challenges. Share price remained low, although it rose 2.3% the day after the announced change in leadership.[7] (See **Exhibit 3**.) In 2007, Home Depot was facing a downturn in the housing market, a principal driver of the home improvement retail industry.[8] Home Depot's chief competitor, Lowe's, was adding stores and directly challenging Home Depot in its previously uncontested turf of urban markets.

Blake also faced skepticism on Wall Street. Like Nardelli, Blake lacked experience in retail. He was also a former GE man, having served as general counsel and head of business development in Nardelli's GE Power Systems division.[9] A lawyer by training, he had worked for the U.S. government after leaving GE and before following Nardelli to Home Depot in 2002 to become his deputy.[10] However, in contrast to the abrasive Nardelli, Blake had a reputation for being a listener and for

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Professor Zeynep Ton and Research Associate Catherine Ross, Global Research Group, prepared this case. This case was developed from published sources. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

seeking consensus.[11] Some analysts expressed surprise that he had not been named merely an interim leader while Home Depot looked for a top retail executive for the post.[12] An analyst at Goldman Sachs commented to *Business Week*: "This is the second-largest retailer in the nation, and [Blake] has never run a company, or one of Home Depot's major operating businesses."[13] To reassure Wall Street and all of the firm's stakeholders, Blake would have to decide rapidly which of Nardelli's strategies to maintain and strengthen, which ones to modify, and which ones to dismantle.

The Home Depot Story

Home Depot was founded in 1978 in Atlanta, Georgia by Bernie Marcus and Arthur Blank. The founders had both been fired from their executive posts at the Handy Dan Home Improvement Centers in California. Rather than seeking employment elsewhere, they sought start-up capital to fund their vision of "one-stop shopping for the do-it-yourselfer"[14]—vast home improvement stores akin to warehouses that would offer a broad selection of tools and products and would be staffed by knowledgeable experts in home improvement and customer service.[15] The new company's first two 60,000 square-foot stores opened in 1979 in Atlanta with 25,000 stock keeping units (SKUs), far more than offered at that time under any one roof.[16]

The company popularized the concept of "do-it-yourself" (DIY), in which homeowners and other individuals purchased products and tools and then built, repaired and improved homes on their own. Home Depot facilitated the DIY concept not only by prioritizing customer service, but also by providing customers with training workshops and clinics to teach them how to go about "laying tile, changing a fill valve, or handling a power tool."[17] Sales associates underwent rigorous training in product use before attending to customers. From the outset, Home Depot was characterized by a close focus on the customer: Bernie and Arthur, as Marcus and Blank were known to employees, championed the customer service philosophy of "whatever it takes," encouraging sales associates to develop relationships with customers rather than seeing sales as a transaction.[18]

The company grew quickly, achieving $22 million in sales in four stores by 1980, and $3.8 billion with 145 stores by 1990, as it became the top U.S. retailer in the home improvement industry.[19] It was the youngest retailer ever to reach $30 billion in revenues, a feat that would be repeated as it attained $40 billion, $50 billion, $60 billion and $70 billion in sales faster than any other retail company worldwide.[20] By January 2007, Home Depot had 1,800 stores in the U.S.,[21] had expanded into Canada, Mexico, Puerto Rico and Chile, and had just entered China.[22] (See **Exhibit 1** for Home Depot performance data.) An average Home Depot store was 105,000 square feet in size and carried 40,000 SKUs[23].

The Home Improvement Industry and Competitive Landscape

Throughout the 1980s, the home improvement industry was fragmented, with sales divided among niche players such as hardware, lawn and garden, and paint and wallpaper stores as well as big box home center stores such as Home Depot and Lowe's. Beginning in the early 1990s, independent stores began losing market share to the growing big box giants, a trend that continued throughout the 1990s.

When the ABC television program *Home Improvement* debuted in 1991, Home Depot's annual sales were about $3.8 billion and the company employed 21,500 people. Throughout the 1990s and into the new millennium, weekend "DIY-ing" became so popular that two cable networks—Home & Garden Television and the Do It Yourself Network—were devoted to the pastime. Fueled by a housing boom—a bubble that since burst—home improvement outperformed most U.S. retail sectors, reaching an estimated $291.3 billion in 2005.[24]

In 2006, the deteriorating housing market negatively impacted the home improvement retail market; the industry reported $200 billion in sales in the U.S. that year.[25] Analysts reported indications of market saturation as well. However, analyst reports were not entirely pessimistic about the strength of the home improvement industry, citing continued population growth and the need for new homes as well as for repair and renovation of existing ones.[26] Providing services such as tool rental, and increasingly, installation was a new trend in the home improvement retail industry—one that became known as "do-it-for-me" or DIFM.[27]

Retailers in the home improvement business carried products such as building supplies and lumber, plumbing and electrical items, tools, hardware, paint and wallpaper, floor tile, upholstery, glass and window fixtures, blinds, lawn and garden supplies and even home appliances.[28] Home Depot was the biggest player in the home improvement market, followed by Lowe's. These two companies were each other's most significant competitors, and held approximately 60% of the U.S. market share between them in 2006.[29] Wal-Mart, America's largest retailer also competed with Lowe's and Home Depot. Hardware stores such as True Value Hardware and Ace Hardware, which maintained cooperatives among independent retailers, followed at some distance, along with hardware store Menard's.[30] (See **Exhibits 4** and **5**.) In 2006, the average size of a transaction for hardware stores was reported to be $15, compared to an average transaction of $41 for home centers.[31]

Big box stores purchased from a wide array of vendors. In 2006, Lowe's received supplies from approximately 7,000 distinct vendors. Efficient management of information and of the supply chain was crucial. The home improvement industry was cyclical. The period from 2001-2006 demonstrated variable growth. See **Exhibits 6**, **7**, and **8** for trends in expenditures for residential improvements and repairs, housing built, and housing sales.

Lowe's

Founded in 1921, Lowe's business had focused primarily on selling materials to contractors, but the housing decline in 1980 resulted in a decrease in profits, prompting the company to rethink its target market. Over a two-year period Lowe's redesigned half of its 229 stores to serve the needs of DIY consumers, creating a friendlier and more accessible setting with softer lighting and full room displays. The design overhaul was a success, and in 1982 over half of Lowe's customers were non-homebuilding professionals.[32]

Lowe's maintained its small store format through the 1980s, a move that potentially cost it the #1 position among U.S. home retail chains, which Home Depot took over in 1989.[33] It was not until the 1990s that Lowe's pursued a warehouse-style layout for its stores. In 1991 Lowe's began to phase out smaller stores and by 1993 it opened 57 warehouse stores, nearly doubling its overall floor space.[34] Lowe's opened more than 140 stores during the 1990s, and in 1998 announced a $1.5 billion expansion plan that would grow the company by 100 stores across the U.S. over several years.[35] Three years later in 2001, Lowe's allocated $2.4 billion for further store expansion and the building of new distribution centers.[36] Between 2001-2002 Lowe's opened over 200 new stores, a trend that continued through 2007, bringing Lowe's total stores close to 1,500.[37] (See **Exhibit 9** and **10** for Lowe's performance data.)

Lowe's rapid growth between 2000 and 2007 reflected the company's growing customer base. The introduction of upscale product lines, home appliances, and installation services, all offered against a welcoming backdrop, helped Lowe's attract new consumers, specifically wealthy baby boomers and women shoppers.[38] The decision to sell home appliances in Lowe's stores resulted in Lowe's ranking second to Sears in U.S. home appliance sales.[39] These successes translated into monetary gain: Lowe's shoppers spent an average of $10 more per trip than Home Depot customers.[40]

Home Depot's First Decades

For its first 20 years, Home Depot was widely known for its entrepreneurial spirit and focus on customer service and sales growth. Stores were run largely informally. Store managers had almost complete autonomy in their own store operations.[41] They were not only allowed but even encouraged by senior management to ignore or send back directives from headquarters that they felt to be intrusive to their own stores.[42] Because it was commonly believed that managers should spend their time on the sales floor with customers, company paperwork often ended up buried under piles on someone's desk, tossed in a wastebasket, or even marked with a company-supplied "B.S." stamp and sent back to the head office. "The idea was to challenge senior managers to think about whether what they were sending out to the stores was worth store managers' time," said Tom Taylor, who started at Home Depot in 1983 as a parking lot attendant and in 2006 was executive vice president for merchandising and marketing.[43]

Merchandising, Store Operations, and Vendor Management

Local autonomy was intended to encourage innovation and responsiveness to the needs and preferences of the local market. "Whether it was an aisle, department or store, you were truly in charge of it," explained a former Home Depot store manager.[44] Store managers decided on merchandizing, displays and promotions and set employee wages. Merchandising was based on each store manager's local market intuition and not on particular metrics, tools or data for quantitative analysis. Nine regional purchasing offices negotiated separately with suppliers. Agreements would vary from region to region. Blank believed that decentralization helped boost sales 15% to 20% because Home Depot buyers understood local needs.[45]

Decentralized purchasing meant that "the retailer was acting as if it were nine $5 billion companies rather than a single $45 billion company, thus squandering the chance to drive down costs and boost gross margins," wrote one industry observer.[46] Promoting autonomy and responsiveness also implied difficulty in delivering on agreements with vendors. In one case, a purchasing center made a deal for garden furniture that included a 10% discount for Home Depot in return for prominent displays in the stores in that region. But many store managers simply ignored the deal, deciding the display was not what their store needed.[47] Home Depot's decentralization also meant there was little communication among managers, and limited ability to negotiate national deals.[48] While the company could generate nationwide store displays from its headquarters, it could not easily coordinate them with nationwide purchasing.[49]

Most Home Depot stores depended principally on full-time personnel who were knowledgeable about home improvement. One analyst in early 2000 praised this strategy as one that kept productivity high and turnover low. "Home Depot traditionally shies away from minimum wage labor and believes that paying the best people will drive higher store sales and productivity."[50]

In 2000, a company executive cited the high level of customer service—a central tenet of Home Depot's management philosophy under Marcus and Blank[51]—as one of two major reasons for Home Depot's success.[52] The company's 2000 annual report referenced a "recent study" in which "Home Depot associates ranked 40% higher than the competition in customer service and product knowledge."[53]

Need for Change

Despite Home Depot's astounding success, Marcus and Blank stated that further growth would require new ways of thinking and doing. The founders pointed out the need to apply new technologies, build efficiencies and reallocate resources, while still listening and responding to customers.[54] To bring more operational discipline to the company, the founders recruited Robert Nardelli from GE.

The Nardelli Era

In his first week as CEO Nardelli asked how to email all 1,134 stores and was told it was not possible.[55] The Atlanta headquarters generally communicated with store managers by fax.[56] In 2000, the company employed 227,000 associates, yet had no head Human Resources officer.[57] Despite its rapid growth and innovative store format, Nardelli said the company had been "in start-up mode for 20 years,"[58] and that the company's decisions were generally "based on emotion rather than data."[59] The retailer was years behind other retailers like Wal-Mart in technology. For example, bills and invoices were largely processed by hand[60] and for those items that did not have barcodes, employees had to manually go to a book to look up the code. There was no general counsel, no chief marketing function, and no CFO. Nardelli quipped, "Call me old-fashioned, but I kind of like the CFO reporting to the chairman."[61]

To respond to falling sales, rising costs and stiffening competition, Nardelli devised a three-part strategy: extending the business into new lines; expanding the market both geographically and with new types of customers; and making existing operations more sound and profitable.[62]

In 2001, Home Depot began providing "specialized products and services to smaller professional customers" and announced the intention of growing the professional business.[63] By 2003, Nardelli had expanded its wholesale business, Home Depot Supply, which provided products and services to a wide range of professionals including real estate developers, plumbers, electricians, construction crews and industrial contractors rather than to the ordinary do-it-yourselfer.[64] HD Supply grew largely through acquisitions,[65] and was a $12 billion business by 2006.[66] Nardelli also expanded Home Depot's market by announcing steps to move into other countries. Previous leadership had already taken the company into Canada, and Nardelli brought it to Mexico. In 2001, 2002, and 2004, Home Depot bought three separate home improvement chains based there. "We went from zero to number one in Mexico," said Nardelli.[67] To him, international expansion and diversification into the wholesale business were strategic responses to the declining U.S. housing market.[68]

Nardelli referred to the central strategy of improving existing operations as "enhancing the core."[69] Several initiatives fit under this banner, including major changes to fundamental retail functions such as merchandising, vendor management, and store operations. In keeping with this focus, Home Depot prominently displayed the new slogan "Improve Everything We Touch."[70]

Changes Introduced in Merchandising

Nardelli centralized Home Depot's merchandising and purchasing. By July 2001, he had reassigned these functions to 12 merchandising vice presidents who would work out of the Atlanta headquarters. Stripped of purchasing power, the former regional purchasing offices' efforts were redirected toward sales, service and supporting stores for the presentation of merchandise procured through the new centralized system.[71] The centralization was aimed at realizing gains in purchasing power and addressing inefficiencies in operations.[72]

In September 2001, Nardelli used his keynote address at the National Hardware Show in Chicago to promote Home Depot's new policy of consolidated purchasing, saying the reorganization would give the regional managers of the chain "more time to convert merchandise into sales."[73] An executive for merchandising and marketing in a Canadian home improvement store commented, "I think what they are doing is absolutely right. When you buy regionally, you find you're losing too much control of your inventory. And when stores don't pay attention to inventory management, you find your customer service goes down because there's too much product on the [sales] floor."[74]

Detractors feared the centralization would lead to stores offering exactly the same product mix, disregarding local variation.[75] But Nardelli maintained that centralized purchasing was necessary for Home Depot to have greater control of over the mix of products available in stores, to ensure greater consistency in merchandising, and to better manage vendors and inventory.[76] By 2003, the company had eliminated almost 20,000 SKUs from its overall inventory and added others—mostly higher-priced, higher-end items aimed at increasing revenue—as part of centralization of merchandising.[77]

Greater purchasing power allowed Nardelli to broker exclusive deals with certain vendors including John Deere, Mill's Pride Cabinets and furniture-maker Thomasville. He placed emphasis on driving relationships with loyal vendors and developing more business with fewer entities.[78] "Two years ago we never could have done [a deal with] John Deere," Nardelli said in 2003. "Every business, every store was their own sourcing center. Now we can negotiate an exclusive arrangement with the strongest national brand in the country."[79] Home Depot used its beefed-up purchasing power to negotiate better deals, extending payment terms to 45 or 50 days up from the typical 30 days.[80]

To support centralized merchandising Home Depot spent over $1 billion to modernize the retailer's technological infrastructure and IT systems, including a new system for inventory management.[81] By 2004, Home Depot implemented assortment planning, markdown management, and store space planning software.[82] By 2005, 11% of sales were replenished automatically.[83]

Six Sigma Approach to Store Operations

Nardelli was a firm believer in the power of process discipline and operational execution. Drawing on his GE training, he was steeped in the culture of Six Sigma, a management methodology that used rigorous analysis to improve quality, and was eager to implement this methodology at Home Depot. With approximately 1.3 billion customer transactions a year, a slight improvement in these key metrics could boost financial performance, he wrote to his shareholders in the 2004 Annual Report.[84]

The Six Sigma method had been pioneered (and trademarked) by Motorola in the 1980s and was later adopted by GE and others.[85] Motorola estimated that it saved at least $15 billion by using Six Sigma from the time of its development through 1999.[86] Former GE CEO Jack Welch, an enthusiastic proponent of the methodology, believed that Six Sigma techniques led to $600 million in savings in 1998 alone.[87]

In its initial use at Motorola and elsewhere, Six Sigma aimed at eliminating defects in manufacturing processes through reducing variation. A defect was defined as nonconformance of a product or service to its specifications and *sigma* referred to a measure of variation. A process with six sigma quality produced less than 3.4 defects per (one) million opportunities whereas a process with three sigma quality produced less than 2.7 defects per thousand opportunities.

The Six Sigma methodology filtered out of the manufacturing world into other business segments, including the management of sales and human resources. A former statistical methods department manager at Motorola said projects that can be "broken down into discrete, manageable activities"[88] are "the right projects for Six Sigma."[89] In the context of retail store operations, processes associated with the flow and storage of products (i.e. in-store logistics activities) were good candidates for Six Sigma process improvement.

The Six Sigma approach was embodied in a four-step process to achieve improved quality: measure, analyze, improve, and control. Measurement was the crucial first step which allowed a company to quantify its quality and accuracy in business processes. Anything and everything could be measured, from the number of high quality parts produced to the time it took to process orders from customers or the number of daily sales made per sales representative. Measurements and variables were then subjected to a process of analysis to determine optimal outcomes and objectives for the performance of certain business processes. Improvement came from changing processes and methods to better achieve the performance goals that had been set. Finally, once new processes were implemented, they were monitored with an eye to controlling and maintaining quality levels.[90]

Changes Made in Store Operations

Consistent with Six Sigma methodology, Nardelli focused on precision, measurement and quantitative analysis to bring to the fore a focus on efficiencies in operational processes. "When I came here, I was told, 'If you get 50 percent compliance, that's a good day,'" Nardelli recalled. "And I said, 'Well, that's not a good day because customers' expectation is to have consistency of delivery not only in the store they shop, but as they go from Home Depot to Home Depot. "We can't live with 50 percent compliance. You have to have 100 percent compliance."[91]

Changes to improve productivity Nardelli's method for improving store productivity included simplification of each store associate's job function with an eye toward more specialization.[92] For example, with the Service Performance Improvement initiative, Home Depot began to stock new inventory at night, so that sales associates could spend more time during the day with customers.[93] Sales associates were still responsible for replenishing products from storage areas during the day. Nardelli also worked on standardizing in-store logistics activities, from the moment freight arrived at the backdoor of the store to its eventual sale or return to the vendor.Productivity metrics were introduced around each step of the freight flow process (e.g. pallets per hour).[94] Stores also had to track "inventory velocity," the length of time it took for products to flow through stores.[95]

To improve labor productivity, Nardelli also invested heavily in technology. Through the Front End Accuracy and Service Transformation (FAST) initiative,[96] all stores were equipped with new point-of-sales terminals with touch screens. These terminals made looking up unbarcoded items simpler and faster for cashiers. Self checkout registers were installed in 800 of the company's highest volume stores.[97] Cordless scan guns were introduced at a number of cash registers after a Six Sigma study found that cashiers were faster and more accurate when they used them.[98] By 2004, cordless scan guns had been installed in all stores, and over 1,000 self-checkout aisles were in operation.[99] By mid-2005, Home Depot had also installed a computerized process to scan incoming inventory.

Changes to increase data accuracy The FAST and back-end scanning and receiving process initiatives were intended to improve accuracy of point-of-sales data and inventory data, respectively. In addition, ordering carts were introduced to facilitate restocking of shelves from storage locations. Home Depot stores received more stock of products to the store than they could present on the display shelves. The extra stock was typically stored on the selling floor in the overheads—the upper shelves that were 8, 12, or 16 feet above. Large products were sometimes stored in the backrooms.

Many products were placed in overheads in areas away from their display locations[i]. Previously, an associate would walk down the aisle and manually write down out-of-stocks from the shelves, take that list to the computer room, generate a report with a "pick list," and then pick those products from the storage locations. With the new ordering cart, associates could walk down the aisles and scan any shelf with an empty space in order to electronically create a pick list. If additional stock of the missing product was present in the store, it was included in the pick list so that associates would know the product was in a storage location and would look for it. In the case of a discrepancy between what the system said the store had in stock and what actually was in stock, associates could make inventory adjustments.[100] That is, associates could change the inventory levels in the computer system to reflect the physical quantities at the stores.

Changes to improve labor scheduling Nardelli invested in tools for Home Depot's store managers to better forecast staffing needs and to schedule labor. The new computerized workload management system allowed store managers to see what activities were scheduled to take place at the store and historical and future trends to inform decision-making about hiring, staffing and training.[101]

Seeking flexibility for scheduling labor at stores, Home Depot announced it would extend benefits to part-time staff. The company tried to increase the number of part-time employees, from 15% of personnel to 50%.[103] Although a negative reaction to this caused top management to backpedal on the number of part-timers hired, the net increase of part-timers was still significant.[104]

Personnel Changes

Nardelli's arrival resulted in significant changes for employees at the corporate and store level. Within two years of Nardelli's arrival, 22 of the company's top 29 managers left.[106] Between 2001 and 2006, 98% of Home Depot's 170 top executive positions changed hands, and over half of the new hires were from outside the company.[107]

In an effort to recruit new managers and train them in the new management approach, Nardelli and Dennis Donovan—a former GE executive whom Nardelli recruited to join Home Depot as his chief human resources officer—developed a two-year intensive program to fast-track new store managers.[108] The program carefully selected participants and aimed to train newcomers in company practices, analytics methodologies and culture.

In 2002, 528 of 1,142 future managers hired from outside the company had military experience.[109] Donovan explained that the company was seeking "people who deliver results, act strategically, and drive excellence," in contrast to traditional store managers who were frequently experts in hardware. "Leaders excel in customer service," he said. "They inspire achievement, they live [with] integrity, they build strong relationships, and they create an environment of inclusion. Junior military officers have these essentials."[110] A former Navy Lieutenant who in 2005 was Home Depot's director of implementation--a position created to standardize processes at Home Depot—agreed. "Military structure is very similar to how our stores are structured," he said. "A store manager is basically the equivalent of a ship captain. You've got a leadership team under you, and I think the relationships you need to build between your hourly and management associates are a natural fit for military leaders."[111] "Bob Nardelli and I have hired military through a big part of our careers, so we know this model works."[112]

[i] Information on storage locations is based on case writer's store observations.

Analyzing Metrics and Making Plan

Nardelli also introduced discipline through data analysis and performance evaluation. Store managers were required to "make plan" by achieving weekly and monthly sales or other performance targets. All personnel were ranked according to four "performance metrics:" financial, operational, customer, and people skills.[113] Nardelli and Donovan placed Human Resource managers in every store to track these metrics.[114] One market analyst gave the new discipline a positive review, saying Home Depot was becoming "much more disciplined, more numbers-oriented and more accountable for everything."[115] To reinforce the new discipline and to better communicate with employees and store managers, Nardelli established an internal TV Channel (Home Depot TV, or "HDTV") that piped in messages to stores.[116] Every Monday night, EVPs for marketing and merchandising delivered the store staff's "marching orders for the week" through a 25-minute live program named "The Same Page."[117] At other times, HDTV ran segments reminding staff of key messages and policies.

Under Nardelli, Home Depot developed personnel incentive plans with the aim of better tying incentives to employee performance. In 2002, the "Success Sharing" program debuted, specifically targeting hourly workers.[118] The program linked employee performance on the new metrics used for evaluation with bonus payments. In 2004, payouts from the program totaled nearly $90 million.[119]

The whole cloth culture change that Nardelli introduced, symbolized by the focus on analytics, did not always lead to the desired results. Managers had to monitor their store numbers, reducing the time they spent on the floor. Former Chief Information Officer Ron Griffin expressed his frustration at having to demonstrate a "return on every nickel."[120] Several stores responded to the "inventory velocity" metric requirement by reducing the amount of inventory coming in, leading to stockouts.[121] A former Home Depot merchandising executive explained, "On paper, all these changes make sense. Unfortunately, they don't work on the floor of the stores."[122] And employees resented the sensation that Big Brother was watching, generated by Home Depot TV. They surreptitiously dubbed it "Bobaganda."[123]

Reactions from Wall Street

Wall Street's initial reaction to the changes introduced by Nardelli was mostly positive. There was widespread agreement with Nardelli's assessment that what had made Home Depot successful in its first 20 years was unlikely to continue to work as the company aimed for $100 billion in revenues.[124] Although some analysts noted that Home Depot under Nardelli opted for a more centralized structure at a time when retailers were devolving more autonomy to stores, many agreed that in Home Depot's case, centralization was a necessary move.[125] Analysts approved of Nardelli's investment in information systems infrastructure, improved supply chain logistics, the strengthened opportunities for economies of scale through the centralization of merchandising, and Nardelli's introduction of greater analytics as a basis for decision-making.[126] Home Depot's strategic alliances with John Deere and others were also cited as strengths.[127] While analysts noted the disgruntlement of present and former employees with the changing culture at Home Depot, it seemed par for the course. Many felt there was bound to be a reaction against cultural change in a company that had previously been famous for and proud of having little corporate discipline.[128]

In 2005, some analysts reflected some reservations. Many doubted Nardelli's strategy to move away from consumer retail and place emphasis on selling to professional contractors through HD Supply. Some analysts asked whether Home Depot was pursuing too many strategic initiatives at once and gave the company a less enthusiastic rating.[129] Other reports fretted about the languishing stock, the housing market and the "disconnect between Nardelli's pay and Home Depot's performance."[130] Nardelli had received $200 million over the previous five years while shareholders saw "cumulative total shareholder returns of approximately -13%." Still, other analysts were bullish enough about Home Depot in late 2005 to place it above Lowe's as their top home center equity because of its positioning for future growth and its relatively low valuation.[131]

Performance Under Nardelli

In addition to the doubling of revenue under Nardelli's leadership, his relentless focus on cost-cutting had been successful in pushing gross margins from 30% in 2000 to 33.8% in 2005. Between 2000 and 2005 Home Depot had a 12% average annual growth rate in sales. Riding the same housing boom, Lowe's had managed to increase its sales by an annual average of 19% over the same time period.[132]

But while Nardelli successfully slashed costs and improved Home Depot's financial management, he did little for the share price. In December 2000, when Nardelli took the reins as CEO, Home Depot's stock price was trading slightly under $37 per share. Six years later when Nardelli left Home Depot the stock was only slightly better off (refer to **Exhibit 3**). By mid-2006 total return to shareholders was down 6%. During the same six-year period, Home Depot's rival Lowe's saw its split-adjusted stock price rise more than 200%.[133] (See **Exhibit 10** for a comparison of share price performance between Home Depot and Lowe's.) Analysts explained the poor share performance as a result of Nardelli's approach to management; one analyst noted that the "numbers were quite good [but] the fact is that this retail organization never really embraced his leadership style."[134]

Customer Service

Research suggested that the slide in customer service was likely related to Home Depot's declining stock price.[135] "He's made Home Depot much more profitable and more streamlined, but messed up everything that has to do with serving the customer," said one analyst. "They've got people in there working for less money and are less knowledgeable and less experienced. It's all about profitability, at the cost of serving the customer."[136] Increased use of part-timers was a source of concern for many. While part-time employees were generally cast in the role of cashiers or shelf-stockers,[137] part-timers undercut a fundamental customer service premise—that of giving the do-it-yourselfer the confidence that prepared staff in orange aprons were available to help. "We built the entire company around the idea that a customer could come in and ask us how to do anything—fix a toilet, build a deck, whatever—and we'd tell them how to do it," said a supervisor at a Florida store. "Now we've got kids who don't even know what the products look like."[138]

Nardelli rejected the notion that an emphasis on part-time staff was inconsistent with excellent customer service. He defended the shift as a positive move for customers who would have more salespeople to attend to them at peak hours. Like the self check-out machines, Nardelli saw increasing the number of part-time employees as a way to ensure better coverage on the floor, and more attention to customers.[139] Investments in store processes and technologies meant that two to three additional associates could be redeployed to the selling floor per store per week to assist customers.[140] Investments in store modernization made stores more attractive.[ii] The centralized merchandising system resulted in higher in-stock levels.[141] One industry expert noted "Nardelli is very acutely aware of the personnel cost of providing personalized service and I think they've done a

[ii] In 2004, the company reported having spent $1 billion on store remodeling and refurbishing.

fairly good job at making the stores as self-serviceable as possible. It's easier to find product than it was before and stores are cleaner and easier to shop."[142]

Yet, many employees who had grown up in the Marcus and Blank era felt the new focus and strategies prevented them from delivering excellent service. Some insiders began referring to the chain as "Home GEpot" or "Home Despot," monikers that leaked out to the business press.

Business Week reported that Nardelli had "alienated customers just as thoroughly as he did employees. Staffing cuts led to persistent complaints that there weren't enough workers in Home Depot's cavernous stores to help do-it-yourself customers."[143] In the summer of 2002, the Better Business Bureau's Atlanta chapter—in Home Depot's hometown—suspended the retailer's membership in response to the skyrocketing number of customer complaints that had remained unresolved.[144] The University of Michigan's annual American Customer Satisfaction Index in 2005 ranked Home Depot at the bottom of the heap of major U.S. retailers in customer service (**Exhibit 11**).[145] The retailer received a score of 67 that year, down from 73 in 2004. The ranking put Home Depot 11 points behind Lowe's and 3 points behind Kmart. (See **Exhibit 12** for readers' comments to *BusinessWeek*'s story.)

By 2006, the CEO and his top executives had realized they had a customer service problem, and elevated the issue to one of their top priorities. Various initiatives were announced to support better merchandising and customer service.[146] Nardelli announced an employee bonus program, called "orange juiced"[147] that would award up to $10,000 bonuses to sales associates for outstanding customer service;[148] Nardelli said, "We open every board meeting with customer service data."[149]

The Road Ahead

Nardelli's departure had been prompted by the quarrel over executive compensation and share price, and not by any rejection of the changes he had introduced to Home Depot. There was widespread agreement that Nardelli had ushered in a technological revolution that had brought the company out of the IT dark ages, and established a series of useful business functions and processes that had not existed under the prior leadership. Yet questions lingered regarding the impact the command and control approach might have had on what had previously been the prized centerpiece of Home Depot's brand: its customer service.

Blake had to decide which of his predecessor's strategies to consolidate, which to alter, and how to go about strengthening a culture of customer service at Home Depot. These decisions would inevitably take place within the pressure of a declining housing market and growing competition in Home Depot's urban markets from the ever more confident Lowe's.

Exhibit 1 Home Depot Performance Data, 1997–2006 ($ amounts in millions, except average customer ticket, number of customer transactions also in millions)

Home Depot	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Gross Margin as a % of sales	28.1%	28.5%	29.7%	29.9%	30.2%	31.1%	31.8%	33.4%	33.5%	32.8%
Amount of inventory	$3,602	$4,293	$5,489	$6,556	$6,725	$8,338	$9,076	$10,076	$11,401	$12,822
Inventory per store	$5.8	$5.6	$5.9	$5.8	$5.0	$5.4	$5.3	$5.3	$5.6	$6.0
Number of stores	624	761	930	1,134	1,333	1,532	1,707	1,890	2,042	2,147
Number of employees	124,400	156,700	201,400	227,300	256,300	280,900	298,800	323,149	344,800	364,400
Number of customer transactions	550	665	797	936	1,091	1,161	1,246	1,295	1,330	1,330
Average customer ticket	$43.63	$45.05	$47.87	$48.65	$48.64	$49.43	$51.15	$54.89	$57.98	$58.90
Same-store (comp store) sales growth	7%	7%	10%	4.0%	--	(0.5)%	3.7%	5.1%	3.1%	(2.8)%

Source: Adapted from Home Depot Annual Report data for 2000–2006, accessed February 21, 2008.

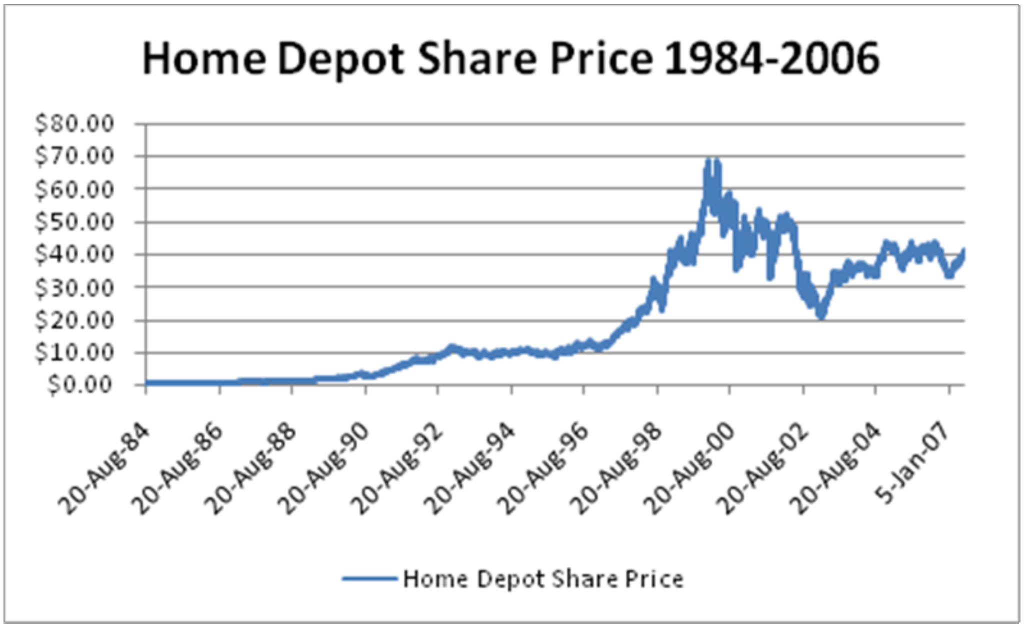
Exhibit 2 Home Depot Income Statement Data, 1997–2006 (in $ millions)

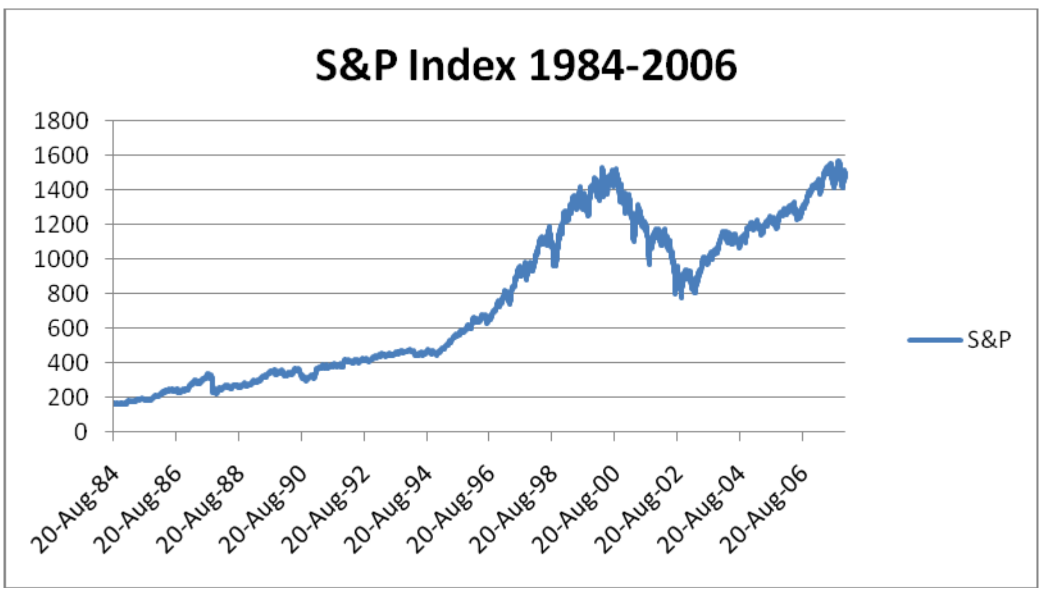
Home Depot	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Sales	24,156	30,219	38,434	45,738	53,553	58,247	64,816	73,094	81,511	90,837
Cost of Goods Sold	17,375	21,614	27,023	32,057	37,406	40,139	44,236	48,664	54,191	61,054
Gross Margin	6,781	8,605	11,411	13,681	16,147	18,108	20,580	24,430	27,320	29,783
Operating expenses										
Selling and Store Operating	4,303	5,341	6,832	8,513	10,163	11,180	12,502	15,105	16,485	18,348
Pre-opening	65	88	113	142	117	96	86	--	--	--
General and Administrative	413	515	671	835	935	1,002	1,146	1,399	1,472	1,762
Non-recurring Charge	104	--	--	--	--	--	--	--	--	--
Total	4,885	5,944	7,616	9,490	11,215	12,278	13,734	16,504	17,957	20,110
Operating Income	1,896	2,661	3,795	4,191	4,932	5,830	6,846	7,926	9,363	9,673
Interest income (expense)										
Interest and investment income	44	30	37	47	53	79	59	56	62	27
Interest expense	-42	-37	-28	-21	-28	-37	-62	-70	-143	-392
Net interest	2	-7	9	26	25	42	-3	-14	-81	-365
EBIT	1,898	2,654	3,804	4,217	4,957	5,872	6,843	7,912	9,282	9,308
Income taxes	738	1,040	1,484	1,636	1,913	2,208	2,539	2,911	3,444	3,547
Net Earnings	1,160	1,614	2,320	2,581	3,044	3,664	4,304	5,001	5,838	5,761

Source: Home Depot annual reports.

Notes: Fiscal years ending: February 1, 1998; January 31, 1999 and January 30, 2000; January 28, 2001; February 3, 2002; February 2, 2003; February 1, 2004, January 30, 2005; January 29, 2006; and January 28, 2007.

Exhibit 3 Home Depot Share Price, 1984–2006 in $USD





Source: Adapted from Google Finance data for August 20, 1984 through August 20, 2006, accessed February 21, 2008.

Exhibit 4 Home Channel Sales, by Retailer, 2004 and 2006

	2004		2006		2004–06	2004–06
Store Name	Sales ($ million)	Share (%)	Sales ($ million)	Share (%)	% Sales Change	% Point Share Change
Home Depot	73,094	19.9	90,837	21.5	24.3	1.6
Lowe's	36,460	9.9	46,900	11.1	28.6	1.2
Wal-Mart	19,200	5.2	23,300	5.5	21.4	0.3
Sears	11,400	3.1	11,500	2.7	0.9	-0.4
CCA Global Partners	8,700	2.4	9,600	2.3	10.3	-0.1
Menards	7,000	1.9	8,000	1.9	14.3	0.0
Pro-Build	4,050	1.1	5,800	1.4	43.2	0.3
Stock Bldg. Supply	3,580	1.0	5,305	1.3	48.2	0.3
Sherwin-Williams	3,977	1.1	5,260	1.3	32.3	0.2
84 Lumber	3,490	1.0	3,920	1.0	12.3	0.0
Total of Top 10	170,951	46.6	210,422	50.0	23.1	3.4
All other	195,548	53.4	211,578	50.0	8.2	-3.4
Total	366,499	100.0	422,000	100.0	15.1	N/A

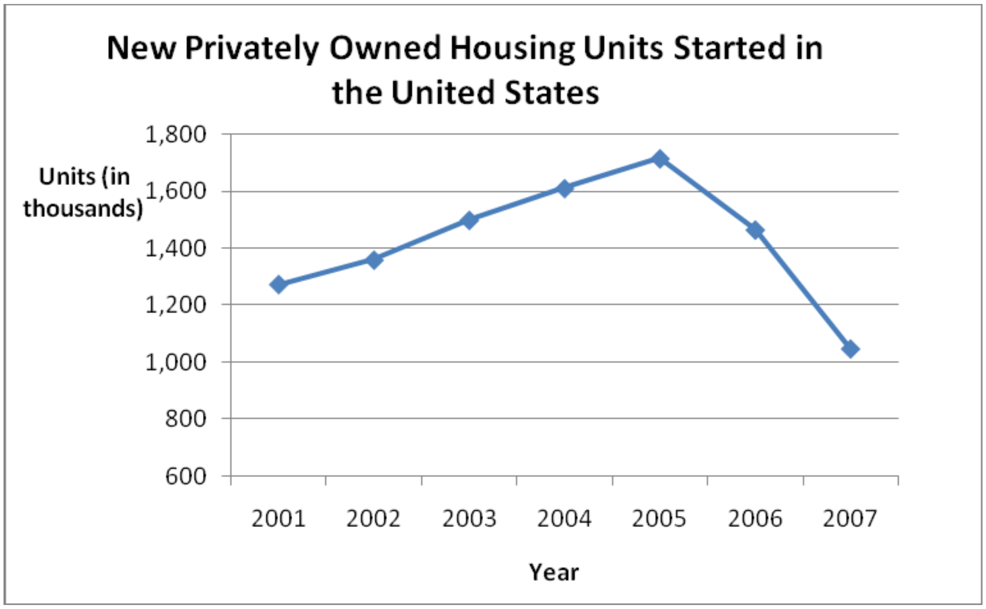
Source: Home Channel News/Mintel.

Exhibit 5 Top Home Improvement Centers' Operating Statistics, Latest Fiscal Year-end, 2006

Company (end fiscal year 2006)	Annual Sales ($ billion)	Outlets (#)	Total Sales Area ('000 sq. ft.)	Employees (#)
Home Depot (1/2006)	90.8	2,147	224,000	364,400
Lowe's (1/2006)	46.9	1,385	157,000	210,142
Menards (1/2006)	8	210	27,000	38,000

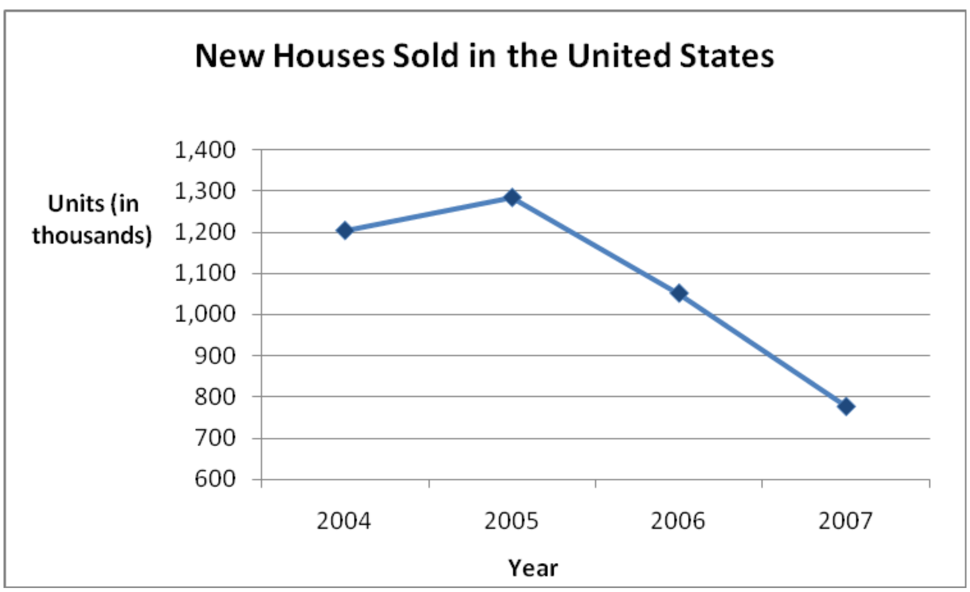
Source: Home Channel News/Mintel.

Exhibit 6 New Privately Owned Housing Units Started in the United States (Thousands of Units)



Source: U.S. Census.

Exhibit 7 New Houses Sold in the United States



Source: U.S. Census.

Exhibit 8 Expenditures for Residential Improvements and Repairs

Seasonally Adjusted Annual Rate in Millions of Dollars

			Improvements		
Year	**Total Expenditures**	**Maintenance and Repairs**	**Improvements**	**Additions and Alterations**	**Major Replacements**
2001	627,300	191,100	436,200	308,300	127,900
2002	689,700	188,300	501,200	353,600	147,500
2003	707,000	179,600	527,400	372,300	155,100
2004	794,100	202,200	591,900	(X)	(X)
2005	860,800	212,900	647,900	(X)	(X)
2006	914,400	214,400	699,900	(X)	(X)
2007	908,400	219,800	688,600	(X)	(X)

Source: U.S. Census.

Exhibit 9 Lowe's Performance Data, 2000–2006 ($ amounts in millions, except average customer ticket, number of customer transactions also in millions)

Lowe's	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Gross Margin as a % of sales	27%	27%	28%	28%	29%	30%	31%	34%	34%	35%
Amount of inventory	$1,985	$2,385	$2,812	$3,285	$3,611	$3,968	$4,584	$5,982	$6,706	$7,144
Inventory per store	$ 4.16	$ 4.59	$ 4.88	$ 5.05	$ 4.85	$ 4.65	$ 4.82	$ 5.50	$ 5.43	$ 5.16
Number of Stores	477	520	576	650	744	854	952	1,087	1,234	1,385
Number of Employees	64,070	72,715	86,160	94,601	108,317	121,600	147,052	161,964	185,314	210,142
Number of customer transactions	231	268	298	342	394	460	521	575	639	680
Average customer ticket	$48.09	$49.70	$53.42	$54.88	$55.96	$57.55	$59.21	$63.43	$67.67	$68.98
Same-store (Comp store) sales growth	4.00%	6.00%	6.00%	1.00%	2.50%	5.80%	6.70%	6.60%	6.10%	--

Source: Adapted from Lowe's Annual Report data for 2000–2006, accessed February 21, 2008.

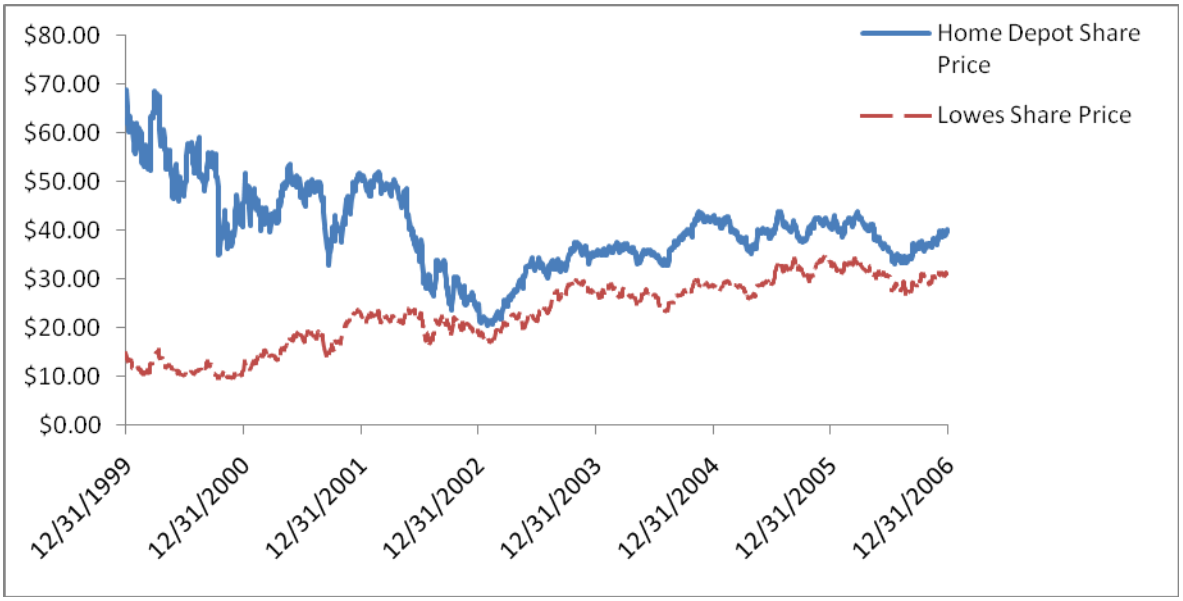
Exhibit 10 Lowe's Income Statement Data, 1997–2006 (in $ millions)

Lowe's	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Sales	$11,108	$13,331	$15,906	$18,779	$22,111	$26,491	$30,838	$36,464	$43,243	$46,927
Cost of Goods Sold	$8,155	$9,757	$11,525	$13,488	$15,743	$18,465	$21,231	$24,165	$28,443	$30,729
Gross Margin	$2,953	$3,574	$4,381	$5,291	$6,368	$8,026	$9,607	$12,299	$14,800	$16,198
Expenses										
Selling, General and Administrative	1,954	2,341	2,772	3,348	3,913	4,730	5,543	7,562	9,014	9,738
Store Opening Costs	73	76	98	132	140	129	128	123	142	146
Nonrecurring Merger Costs	--	--	24	--	--	--	--	--	--	--
Total	2,027	2,417	2,894	3,480	4,053	4,859	5,671	7,685	9,156	9,884
Operating Income	$ 926	$ 1,156	$ 1,486	$ 1,811	$ 2,314	$ 3,167	$ 3,936	$ 4,614	$ 5,644	$ 6,314
Depreciation, Interest Income (expense)										
Depreciation	256	289	337	409	517	626	758	902	980	1,162
Interest	72	81	85	121	174	182	180	176	158	154
EBIT	$ 598	$ 786	$ 1,064	$ 1,281	$ 1,623	$2,359	$ 2,998	$ 3,536	$ 4,506	$ 4,998
Income Tax Provision	216	287	390	472	601	888	1,136	1,360	1,731	1,893
Net Earnings	383	500	673	810	1,023	1,471	1,877	2,176	2,765	3,105

Source: Adapted from Lowe's Annual Report data for 2000–2006, accessed February 21, 2008.

Note: Fiscal years ending: January 30, 1998; January 29, 1999; January 28, 2000; February 2, 2001; February 1, 2002; January 31, 2003; January 30, 2004; January 28, 2005; February 3, 2006; and February 2, 2007.

Exhibit 11 Comparison of Share Price of Home Depot and Lowe's, 2000–2006 in $USD



Source: Adapted from Google Finance data for December 31, 1999 through December 31, 2006, accessed February 21, 2008.

Exhibit 12 University of Michigan American Customer Satisfaction Index Scores, 2000–2006

Category: Specialty Retail Stores

Company	2000	2001	2002	2003	2004	2005	2006
Costco Wholesale Corporation	77	76	79	80	79	79	81
SAM'S CLUB (Wal- Mart Stores, Inc.)	74	78	77	77	75	76	78
All Others	NM	72	73	73	75	73	75
Lowe's Companies, Inc.	NM	75	76	77	76	78	74
Specialty Retail Stores Average	**76**	**73**	**74**	**74**	**75**	**74**	**75**
Best Buy Co., Inc.	NM	NM	NM	72	72	71	76
Circuit City Stores, Inc.	NM	NM	NM	73	72	70	69
Home Depot, Inc., The	NM	75	71	73	73	67	70

Source: http://www.theacsi.org/, accessed February 21, 2008.

Exhibit 13 Comments to *BusinessWeek* Cover Story: "Renovating Home Depot," March 27, 2006

Our Mar. 6 Cover Story, "Renovating Home Depot," took a close look at the corporate culture that Chief Executive Robert L. Nardelli is trying to build—one that's based in part on military concepts and personnel. We argued that the command-and-control discipline Nardelli has imposed is getting financial results. But a deluge of letters, online posts, and message board responses—nearly 300 in all—indicates the overhaul has come at a cost. Many readers connected the military-style ethic promoted by Nardelli to a decline in customer service at Home Depot stores. In a startlingly similar refrain, they complained of indifferent workers, long lines, and unpleasant stores. Only two correspondents praised America's largest home supply store. What follows is a sampling of reader reaction, with a reply from Home Depot

CUSTOMER VIEWS

As a submarine Navy veteran, as well as a General Electric (GE) veteran (Heavy Military Electronics), I can only applaud Home Depot's military-style management and Robert Nardelli. What's missing is focus on the customers. I'm also a veteran home improver. I've watched Home Depot under Nardelli follow in the footsteps of Northern Virginia's now-defunct Hechinger stores, while Lowe's (LOW) eats Home Depot's lunch.

Anonymous

Gross sales at Home Depot may be soaring, but the customer service is, well, just gross. For example, Home Depot stores have lots of checkout lanes, but often most of them are closed, and they attempt to push customers to the awful self-checkout area. I wrote a letter to Home Depot corporate and told them I did not wish to become their unpaid employee, even for five minutes.

Jeffrey E. Schmidt
Kissimmee, Fla.

I searched "Renovating Home Depot (HD)" in vain for some reference to military veterans' value as employees—besides their maturity, discipline, and a willingness to relocate to unsavory locales.

The veteran employee's ability to "think on his feet" was praised, but the critical plans are now being made by Home Depot central management. I read no reference to how the plans are developed—for example, how those target sales numbers (nervously tracked by store managers on their BlackBerrys) are defined. What thinking is the veteran employee empowered to do?

Similarly, Home Depot has responded to its "strategic" needs by replacing its seasoned, well-compensated professional staff with a vast crew of business personnel who will be willing to accept more demands and question authority less. It seems that decisions are being made strictly on the basis of numbers, often without a sense of their root cause or interconnected nature.

Jennifer Kirley
(Formerly HT1 Hull Maintenance Technician First Class, U.S. Navy), Greene, Me.

The first problem at Home Depot after Nardelli's arrival was extensive violation of Carl Liebert's "Customers cannot buy what we do not have" slogan. When Home Depot first appeared on the scene, before Nardelli, it corrected two flagrant problems that were Hechinger's undoing: out-of-stock items, poor display of existing stock, and floor employees' lack of responsiveness to customers. Home Depot, before Nardelli, was fully stocked and hired people in the trade who were available in force on the floor. They understood the stock and could help customers use it.

Many of us now find broader and more complete stock, along with better staff availability and knowledge, at Lowe's. I go more than an extra mile to shop accordingly. Home Depot would do well to change its focus from command-and-control to customers.

George F. Steeg
Potomac Falls, Va.

I applaud CEO Bob Nardelli's efforts to make the shopping experience consistent throughout each store. He has brought order to what was at times an experience in futility trying to find a particular item. Unfortunately, it provides me the speed and efficiency I crave for all the wrong reasons—to get in and out of the place as quickly as I can so that I don't have to hear the workers gripe about yet another change being implemented by senior management.

Scott Haines
Foster City, Calif.

I recently visited Home Depot to buy a simple polyvinyl chloride (PVC) elbow for my sprinkler system, something that probably would cost less than a dollar. After spending an inordinate amount of time just looking for the item, I went to the front of the store only to be greeted by one clerk and two checkout lines, 10 to 12 people deep. It wasn't worth the wait. Shop again at Home Depot? Never.

Larry Paquette
Fresno, Calif.

After reading the Cover Story, I have to say I am a Nardelli supporter. Having experience in the Marine Corps during Vietnam and also as a manager of 1,000 people in business, I see great parallels for success. Most successful businesses require balanced performance—financial, operational (or process improvement), customer focus, and developing people. To deem this militaristic when it is just good business is a bit naive. In today's all-volunteer military, there is much more focus on balanced performance and people skills, as opposed to the blood-and-guts perception created by Hollywood. To keep the volunteers, the military has actually improved more quickly than some U.S. businesses. To hire people who are well-trained is an excellent strategic advantage for which I commend Mr. Nardelli.

Richard Jozwiakowski
Round Rock, Tex.

* * * * *

HOME DEPOT RESPONDS

With 1.3 billion transactions a year, we're bound to make mistakes, but nothing disappoints us more than letting down a customer. We're making continuous improvements in our customer service levels and are working harder than ever to make sure that our service delivery meets the high expectations our customers have of Home Depot.

Jose Lopez
Senior Vice President Chief Customer Officer, Home Depot Atlanta

Source: BusinessWeek.

Endnotes

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