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The Home Depot: China

The Importance of Understanding International Markets

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Introduction

The Home Depot is a home improvement superstore that sells building materials, tools, and services. It was founded in 1978 by its co-founders Ron Brill, Pat Farrah, Arthur Blank and Bernard Marcus. Its headquarters are located in the United States, Georgia. In June 1979, they opened their first store in Atlanta, Georgia. The Home Depot was built with the vision of a superstore that offers a huge variety of merchandise at great prices.

The original stores hired retired construction workers with expertise that provided customers with guidance. With exceptional customer service, the company was able to gain the loyalty of American homeowners.

The primary target customer of The Home Depot is homeowners that are looking for tools, materials, and advice on completing home improvement projects. Product offerings range from lawn and gardening equipment to building supplies and seasonal assortments.

Some of the services The Home Depot has grown to provide, include providing hands-on instruction and in-store workshops. Additionally, with its massive distribution capability, the company has attracted major brands like RIDGID and Behr.

The Home Depot has grown to more than 2,200 stores in three countries that include the United States, Canada and Mexico. As it has expanded into new markets, the company has learned to adapt to different market needs. The Canadian and Mexican market entry was accomplished through the acquisition of established companies. These companies provided expertise in cultural differences and the unique strategies of those markets. However, The Home Depot preserved its goal of earning customer loyalty by offering quality services, a broad selection of products, and competitive prices.

In 2006, The Home Depot capitalized on a growth opportunity by acquiring twelve The Home Way stores in China. By September 2012, the company had closed seven of the twelve original stores. In this paper, we will analyze the company's entry strategy, mistakes that led to failure, and viable alternatives.

Entry Strategy

With a population of over one billion and rapid economic growth, the Chinese market is a highly attractive market. The Home Depot detected an opportunity for growth in China after IKEA's successful market entry, and other established companies with similar business models gave The

Home Depot confidence. This coupled with the booming Chinese housing market, provided The Home Depot with a potentially lucrative growth opportunity.

Established foreign firms like IKEA, Homemart, B&Q, and Orient Home gave The Home Depot further confirmation that the market was mature enough for their entry. IKEA, as a do-it-yourself retailer was doing very well in the Chinese market, this confirmed The Home Depot's belief that the Chinese market was receptive to Western businesses.

With relatively low perceived risk, The Home Depot entered the market by acquiring The Home Way. The Home Way was modelled around The Home Depot business model, so integration with its business was seamless. While The Home Depot is a leader in the home improvement sector in North America, it did not understand the Chinese consumer. The Home Way provided The Home Depot with insights into the Chinese market, including the knowledge to adapt to Chinese culture.

The decision to make a Foreign Direct Investment with the acquisition of The Home Way was made to speed up market entry and reduce entry costs. The costs of market analysis, establishing supplier relationships, building stores, and receiving permits from the government were mitigated. Additionally, in the process of acquiring the Home Way, a transfer of knowledge occurred. This was very valuable to the Home Depot because they had limited knowledge of the Chinese market and the specific demands of the consumer.

With homeownership rising and Chinese consumers looking for home decor inspiration, there were relatively few competitors. Other than home furnishing companies, which served as indirect competitors, there weren't many home improvement stores offering the same variety of products.

The Home Depot was further differentiated in that it offers Western products and Western designs, consumers look to The Home Depot as a window into what a Western home should look like.

Reasons for Failure

There are many reasons for The Home Depot failure in the Chinese market, including failure to adapt to the different style of living, failure to adapt to Chinese consumer shopping patterns, inadvertently targeting the wrong consumer, and failure to adequately position its stores.

The typical American home is pre-built with standard specifications for an entire neighbourhood. Homebuyers choose from a pre-set list of options to add some uniqueness to their home. This strategy helps reduce the cost of building because builders buy materials at large scale.

Additionally, this brings down development time, because contractors are comfortable with the design specifications.

In comparison, Chinese consumers are design-conscious and typically have specific requests from builders. This raises the construction cost since builders have to adapt to each customer's requests. With a booming population, growing middle class, and a need for more housing, builders choose to build stripped condominiums. Chinese home buyers are responsible for handling the installation of flooring, kitchen cabinetry, lights, etc. This allows builders to construct projects quickly, lower costs, and gives buyers a chance to customize their homes to their liking.

With this in mind, Chinese customers rely on the expertise of contractors and store employees when making buying decisions. Contractors serve as representatives for home buyers and help explain the differences between product offerings, their benefits and disadvantages. The Home Depot decided to market to homeowners to help them modify their home, the same strategy as the U.S.

As a home improvement store, Chinese consumers see no need to buy there. They usually rely on contractors to help with decision making, material procurement, and installation. Chinese consumers also distrust large stores like The Home Depot, because they feel that there is no way employees understand all of the products sold there.

The Home Depot stores are located in suburban areas, the same model as in the U.S. In the U.S. the middle class typically lives in the suburbs, this group of people have disposable income and have a do-it-yourself mentality. In contrast, the Chinese middle class typically lives in the city and have a do-it-for-me mentality. The Home Depot placed its stores far away from its target market and marketed to customers that prefer to pay rather than doing.

Typical American suburban dwellers have large backyards with space to store construction materials and equipment. In China, city dwellers don't have space to store construction equipment and see no need to waste space with the equipment they won't use often. Instead, they prefer to rely on a contractor that has the expertise and equipment to build what they are looking for.

In the American market, men typically make buying decisions when it comes to home improvement. Chinese home improvement buying decisions are typically made by women. An example of this is IKEA, women typically go out and look at the models set up in store for design inspiration.

Homeownership is a relatively new concept in China since under Communist rule housing was under government control. As Chinese consumers are increasingly becoming first-time homeowners, they are looking to the West for inspiration. Helen H. Wang, a consultant on China's middle class, stated that "many people have little sense of how to furnish or decorate a home. They are very eager to learn from the West."

Strategic Alternatives

The Home Depot's rigid business plan, lack of market research, and overreliance on its acquisition led it to fail in the Chinese market.

The simplest alternative for The Home Depot is to follow what B&Q did when entering the Chinese market. B&Q restructured its business model to adapt to the needs of its new consumers (which The Home Depot was not able to anticipate and do properly). The lack of flexibility in their business plan led The Home Depot to fail in the Chinese market. On the other hand, B&Q was able to see its mistakes and correct properly, adapting to the tastes and preferences of the market.

Therefore, the first alternative would be to propose a different business plan in this market in relation to what it does in the rest of the countries where it operates. They can take as an example the structure of their competitors' stores (B&Q, Homemart, Orient Home). Some changes that can produce great benefits for The Home Depot are as simple as modifying the structure of their stores in a way the customers would like them. As seen in the B&Q case, the reordering of products resulted in a positive response from consumers in China.

Additionally, as mentioned before, women are the home furnishing decision-makers in a Chinese household. Instead of making large warehouses that are unappealing to most women, The Home Depot should have adapted its stores to a much smaller footprint. Model set-ups would provide consumers with ideas on how to design and furnish their homes, which would aid contractors.

Second, stores in urban areas are better suited for The Home Depot's goals. In China, urban areas are where the high and middle-class consumer tends to live. By placing stores in urban areas customers would have easy access to their stores and be more likely to spend money there.

Unfortunately, The Home Depot's stubbornness to remain a large store with endless options for customers forced it to place stores in the suburbs, where space is abundant. Thus, the company became irrelevant to its target market.

Third, marketing and building partnerships with contractors gives The Home Depot the opportunity to build trust with customers. Contractors serve as the advisors for Chinese consumers, they are able to explain brands and product uses. The Home Depot attempted to provide customers with paid brand advisors that only alienated customers because they failed to provide unbiased opinions. Contractors, on the other hand, are perceived to have the customer's best interest in mind.

By building partnerships with contractors, The Home Depot is able to build trust with customers. Additionally, since the Chinese consumer has a do-it-for-me mentality it would be futile to advertise construction materials to homeowners.

Another factor to consider when opting for partnerships with contractors over large warehouse-style stores is the shopping pattern of the Chinese customer. A typical Chinese consumer will shop around and compare prices and options at multiple shops before coming to a decision. Additionally, they typically seek guidance from the shop owner on making a decision and expect an explanation of the product features. Large warehouses make the Chinese consumer feel like the store is unqualified to explain product features, and possibly sells low-quality products.

Conclusion

In conclusion, it is important for any business seeking to expand internationally to understand their market. The Home Depot entered the Chinese market with the confidence that its acquisition of The Home Way would provide it with market insights.

Additionally, executives analyzed the Chinese market with a North American lens, which impaired their ability to see where their target market was located. The Home Depot failed to position itself where its target market is, didn't adapt to consumer shopping patterns, tastes, and preferences, and lastly was blinded by its aim to be a home improvement warehouse.

To adapt itself to Chinese consumers, The Home Depot could restructure its stores to appeal to the decision-makers, position its stores in urban areas, leverage contractor relationships, and reduce the footprint of its stores.

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