ARTHUR BLANK AND BERNIE MARCUS

The Home Depot

ARTHUR BLANK AND BERNIE MARCUS:
THE HOME DEPOT STORY

by

Dr. Richard E. Hattwick
Professor of Economics (Retired)
Western Illinois University

Arthur Blank and Bernie Marcus revolutionized the home improvement industry with their Home Depot chain of retail stores. They not only conceived of a new way of running the business but also succeeded in implementing their vision. They opened their first store in Atlanta, Georgia in 1979 and completed the transition to successor management at the end of 2000.

As the following profile suggests, two other individuals played critical roles and deserve some recognition as co-founders and company leaders. Pat Farrah was a gifted merchandiser who was part of the original team and may have been a stronger motivational force among the rank and file than were either Blank or Marcus. Ken Langone was an investment banker who provided critically needed funds and encouragement. Once Home Depot was an established big business, Arthur Blank began hosting an annual golf tournament for the company founders. Four people were invited to play - Blank, Farrah, Langone and Marcus.

THE FOUNDERS' BACKGROUNDS

Both Blank and Marcus were seasoned retailing executives at the time they co-founded Home Depot. After starting their business careers, independently and unaware of each other, they then came together as a management team for the Handy Dan chain of home improvement stores in Los Angeles, California. During their time at Handy Dan they became acquainted with Ken Langone and Pat Farrah.

ARTHUR BLANK

Arthur Blank was born in 1942 and grew up in an apartment in the Queens section of New York City. He admired his father who was a popular neighborhood pharmacist. The father also started a mail-order pharmaceutical company named Sherry Pharmaceutical. When the father died in 1957, Arthur's mother decided to run the small business. She was successful enough to send her two sons to private schools.

Arthur paid for his college education at Babson College by running two businesses - landscaping and laundry. He graduated with a bachelor's degree in accounting. Among his distinctions were a straight-A average and the presidency of his senior class.

Following graduation Arthur went to work for almost five years as a staff person at Arthur Young and Company, one of the Big Eight accounting firms of that era. Then he joined the family mail order business. His brother had already earned a college degree in pharmacy and was helping the mother run the business at the time.

In 1968 the family firm was sold to the Daylin Corporation. The Blank family continued to manage the business for awhile. Then, in 1970, Arthur was named chief financial officer of another Daylin unit - Elliott's Drug Stores/Stripe Discount Stores. Daylin's president (Max Candiotty) and senior vice president (Leon Beck) noticed Arthur and became his mentors. As a result, in 1972 he was promoted to president of the Elliott's. He was also named assistant treasurer of the parent company. Arthur recalls his days at Daylin as showing him a healthy way of running a business and of instilling in him a new awareness of what he wanted to do in the future. As he once put it (Marcus and Blank, p.19):

> *"I remember having many good personal relationships at Daylin in those days. It was a less structured, less hierarchical corporate environment, a family culture where people supported each other and cared for each other.*
>
> *"Becoming president of that division at an early age fed my entrepreneurial spirit. It encouraged my capacity for starting and running a business, for wanting to make decisions, for wanting to be part of everything."*

In July 1974 Daylin decided to sell several divisions, including Arthur Blank's Elliott unit. Arthur decided to leave Daylin and accepted an offer to join the Handy Dan home improvement company as corporate controller. His new boss was Bernie Marcus.

BERNIE MARCUS

Bernie Marcus was born in 1930 and grew up in a Newark, New Jersey tenement district. His parents were poor Russian immigrants who arrived in America without being able to speak English. However, both parents had strong personality characteristics which appear to have been picked up by Bernie. His mother instilled in him such positive traits as a positive mental attitude, a desire to make a difference, learning from setbacks, and the importance of giving to others. His father demonstrated an awesome work ethic. He was a cabinetmaker who worked seven days a week, fifteen hours a day. However, the father wasn't able to support the family on his own and that, too, made an impression on young Bernie.

Bernie's parents also made religion an important part of his life. They were Orthodox Jews who had fled to the United States in time to avoid becoming part of the Holocaust. Bernie grew up in an atmosphere where going to the synagogue and following the scriptures in daily life were emphasized. As an adult he did not maintain the commitment to Orthodoxy that his parents had, but he retained a strong belief in God and in living his life according to the values of his Jewish heritage.

The Jewish heritage also provided Bernie with a strong work ethic. As he puts it (Marcus and Blank, p.7):

> *"I understand the frustration that blacks faced in America years ago. Jews suffered the same obstacles. Large corporations, banks and industries were devoid of Jews in positions of authority. We couldn't belong to exclusive clubs or high society. So we had to work harder and smarter to succeed."*

During his grade school years Bernie had to put up with constant attacks by gang kids. Eventually he earned the respect of one of the gang leaders, was asked to join the gang, and became the gang leader's right hand man. He was the only white boy in the gang of thirty black youth.

As a teenager Bernie worked at a soda fountain after school and spent summers working as a bus boy at Catskill resorts. His goal was to attend college and become a psychiatrist. He started reading the writings of Freud and Jung and learned how to hypnotize people.

Bernie started college as a premed student at Rutgers College. He had hoped to go on to Harvard Medical School but was unable to come up with the money that was needed. And so he ended up earning a degree in pharmacy from Rutgers.

Following graduation Bernie accepted an offer to become co-owner of a friends pharmacy in Millburn, New Jersey. One Saturday night while he was working at the store a customer offered Bernie an unexpected opportunity to change careers. The customer suggested that Bernie obtain a concession running the cosmetics department within a discount store. Bernie followed up on the suggestion and ended up with a concession in Spears Fifth Avenue. His partner in the Millburn pharmacy agreed to borrow against the pharmacy assets to provide the funds needed to start the discount operation. It was agreed that Bernie would run the discount concession while the partner would run the pharmacy and they would share the earnings.

The concession at Spears was short-lived because Spears was going bankrupt. Determined not to fail with Spears, Bernie followed the suggestion of a friend and decided to attempt to obtain the cosmetics concession at the Two Guys store in Totowa, New Jersey. Bernie met the founder and owner of Two Guys, Herb Hubschman, and convinced Hubschman to let him have the concession. Bernies sales pitch included a promise of achieving unheard of sales volume as the new concessionaire. He was so convincing that Hubschman provided the funds to allow Bernie to pay off his debts elsewhere. As part of the change Bernie left the drugstore to his old partner.

Bernie achieved significant success with his cosmetics department concession. Two Guys rewarded him by putting him in charge of additional areas for the entire Two Guys chain - first sporting goods and then major appliances. Bernie eventually had control of $1 billion worth of business flowing through the Two Guys chain.

Two Guys was an East Coast retailing star in those days. Its huge stores offered everything from groceries to appliances. It dominated such product categories as appliances, fans and lawn furniture. It was to a large degree a forerunner of the superstores created decades later by Wal-Mart. But founder Hubschman died and the company was subsequently sold to outsiders who were unable to maintain the company's competitiveness. Bernie became disillusioned by the slumping financial performance, the loss of focus on the customer, and the decline in team spirit. He left Two Guys in 1968 not knowing for sure what he would do next.

He did not have to wait long. He was contacted by the Odell manufacturing company in California and offered the position of company president and chief operating officer. That company manufactured consumer products such as shoe polish. Bernie accepted the offer and joined Odell in June 1968. Two years later he moved to the Daylin Corporation as a vice president in charge of a division which operated 34 discount stores along with several other duties. Then he was moved to California to manage the Handy Dan Home Improvement Centers chain. There he would become acquainted with Arthur Blank and Ken Langone, and eventually with Pat Farrah.

PAT FARRAH

Pat Farrah was, "The son of an oil surveyor (who) grew up in Southern California and dropped out of junior college after just three months. .. 'I wasn't sure college was going to help me,' says Mr. Farrah. 'I felt I was pretty bright anyway.' " (Hagerty, p.B1).

Pat took a job as a lumber man at National Lumber and Supply Company in the Los Angeles area in 1962. He exhibited such outstanding product knowledge and customer service skills that National Lumber appointed him manager of the company's second store. He did so well as a store manager that the company relied on him to open its third and fourth stores. Then he was made vice president and general manager of National Lumber and proceeded to open three more stores.

In 1977 he left National Lumber because National Lumber's owners refused to follow through with the planned acquisition of a supplier of hot tubs. Pat had made promises to the seller and was upset that he would not be able to keep those promises. But Pat had been thinking about a revolutionary new concept in home improvement retailing and by leaving National Lumber he created the opportunity to implement those plans.

Five of National Lumber's store managers quit to join Pat in his new venture. Pat obtained venture capital, obtained a line of credit, found an empty store, and opened his revolutionary new retailing outlet in January, 1978. The business was called Homeco and it was very similar to the home improvement stores that Home Depot would later introduce. Through Homeco Pat would end up becoming a partner with Bernie Marcus, Arthur Blank and Ken Langone.

KEN LANGONE

Ken Langone began his professional career as a banker at the New York investment banking firm of R. W. Pressprich. He made an early reputation by winning the initial public offering of Ross Perot's Electronic Data Systems. From Pressprich he moved to the investment banking firm of Invemed Associates where he was president. He was always on the lookout for highly profitable stock acquisition opportunities. So when he discovered that Handy Dan (managed by Bernie Marcus) was the benchmark for its industry he hatched a plan to acquire the sixteen percent of Handy Dan's stock that was held by the public. Prior to launching that effort he met with Bernie to learn more about Handy Dan. Langone and Bernie became friends and mutual admirers. As a minority owner of Handy Dan Langone gave Bernie moral support and protected him against the head of the holding company that owned the majority of shares, Sanford Sigiloff. Sigiloff was able to move against Bernie and Arthur only after Langone and his investment group agreed to sell their holdings of Handy Dan back to Sigiloff. Then Langone prodded Bernie to start a new home improvement chain and found the financing Bernie needed.

MARCUS AND BLANK ARE FIRED BY HANDY DAN

Founded in 1955 and headquartered in Los Angeles, Handy Dan was regarded by some people in the industry as the benchmark home improvement company. The Daylin Corporation owned 81 percent of Handy Dan's common stock and the rest was in the hands of the public. Consequently, Handy Dan had its own board of directors, separate from the Daylin Corporation board. Bernie had joined Handy Dan as president and was subsequently named chairman of Handy Dan's board of directors. But since Daylin held 81 percent of the stock, Bernie was ultimately subject to the wishes of Daylin's CEO, Sanford Sigiloff.

After Arthur Blank joined Handy Dan, he and Bernie Marcus became a close management couple. The positive chemistry between the two made them constant companions at work. They had lunch together almost daily. Bernie found Arthur to be a particularly good listener. Gradually, even though his job title said Chief Financial Officer, Arthur became involved in a far wider range of company matters.

Handy Dan's performance under Bernie Marcus' leadership was outstanding. In 1976-77 Handy Dan won the Home Center of the Year Award given by the Brand Names Foundation. In 1976 Handy Dan earned $7.8 million before taxes. Daylin, as a whole, only earned $7 million. Bernie was so successful that there was talk of him being the logical next CEO of the parent corporation, Daylin (replacing Sigiloff). That success and visibility might account for the fact that the relationship between Marcus and Sigiloff became so strained that Sigiloff fired both Marcus and Blank. Marcus certainly thought that professional jealousy was at the root of his termination (Marcus and Blank, pp.32-33).

But Sigiloff could not simply fire Bernie for personal reasons, much less for failure to perform. There had to be another reason and Sigiloff found one. On April 14, 1978, without any advance notice to Marcus or Blank, Sigiloff fired the two men and a third executive named Ron Brill. Bernie had hired Brill as Handy Dan's director of internal audit. The three were accused of violating the law in the process of supporting a labor union decertification effort. (They were accused of setting up a $140,000 fund to support the decertification effort.) At the same time he fired the three, Sigiloff informed the Justice Department and the Securities and Exchange Commission. Both agencies had the authority to prosecute the offenders. All three men denied the charges and incurred substantial legal costs preparing to defend themselves should the government take formal action. But, after reviewing the evidence, the government chose not to take any action.

A more complete discussion of this issue and the broader relationship with Sigiloff is presented by Marcus and Blank in their 1999 book (pp.20-39) and in Roush (1999, pp.3-4). Roush accepts the Marcus-Blank denials after reviewing the evidence. He justifies his conclusion, in part, with the following quotation from a Handy Dan merchandising manager who worked with Bernie and Arthur from 1973 to 1979, and told Roush they couldn't have possibly broken the law, saying (Roush, p.4):

> *"I worked with them too long. In terms of honesty and integrity, they're impeccable, just impeccable."*

THE HOME DEPOT VISION BECOMES AN ACTION PLAN

The day after he was fired, Bernie received a call from investment banker Ken Langone. As noted above, Langone and Bernie had become close friends after Langone put together the investment group which purchased the publicly available shares of Handy Dan. Langone was delighted to hear that Bernie had been fired and told him so during his Saturday telephone call. Here is how Bernie recalls what Langone said (Marcus and Blank, p.37):

> *"That is the greatest news I have ever heard. Now we can open up the store you talked about back in Houston. You guys have been really hamstrung and haven't been able to do a lot of the things you wanted to do, and it is pretty clear to me, as an investment banker and financier, that you have a lot more capacity than what you can do here. Don't view this as a negative. You never know where life is going to take you. This is a great opportunity for you to do your own thing - let's go into business together*."

The Houston reference was to a day when Handy Dan opened a new store in Houston, Texas and Langone had joined Bernie for the grand opening. During a private moment between the two Bernie had revealed his vision of a revolutionary new approach to the home improvement industry. What he had in mind was the essence of what became Home Depot - a national chain of stores larger than anyone imagined could be profitable; a chain that would knock out the smaller competitors by virtue of low prices.

Bernie didn't dismiss the idea of starting a new venture, but he was preoccupied with suing Sigiloff to get back the more than $1 million which Bernie felt was owed him as a result of his termination. Then he had a conversation with Sol Price which caused him to drop the suit and focus on the new venture. Price related from his own experience how a lawsuit can soak up time, attention and money and predicted that if Bernie persisted in the suit he would never be able to start the new venture. Bernie chose moving on over justice and revenge. He began meeting with Arthur Blank to plan a new home improvement venture.

The basic concept came from Bernie. He envisioned a huge warehouse store of 55,000 to 75,000 square feet compared to the 35,000 square feet of the largest Handy Dan store. There would be no middlemen. Merchandise would be purchased directly from the manufacturer and would be delivered directly from the manufacturer to the stores. Sales volume would be $7 to $9 million thereby allowing the stores to be profitable with gross profit margins of 29 to 31 percent compared to the industry norm of 42 to 47 percent. This would allow the new chain to be profitable at prices sharply below the traditional competitors who might do an annual volume of $3 million. The stores would stock large assortments of merchandise in large amounts and the merchandise would be displayed in the high ceiling warehouse store in a manner that implied bargains for the customer. In addition to the low prices, customers would be motivated to make purchases by trained sales people who would help the customer determine what was needed to make the home repair or home improvement.

One problem immediately arose in the planning stage - the sales projections fell short of the volume needed to make the concept work. Finally the two entrepreneurs made a leap of faith and assumed that sales could be pushed to the level needed for success.

The plan on paper was ready when Ken Langone called with news that he had lined up $2 million in venture capital from Ross Perot. The proposal was to give Perot seventy percent of the new company's common stock. As negotiations progressed with Perot, Bernie began to worry about Perot interfering with management decisions once the company was up and running. Bernie's experience with Sigiloff made him particularly sensitive to this issue and to the fact that a majority owner could fire Bernie if there were to be a conflict. So Bernie backed out of the deal at the last minute. Langone then turned to his network of venture investors and managed to raise $2 million from a group of them. The final financial arrangement gave those investors fifty percent of the company's equity.

The $2 million of outside investment funds made it possible for Bernie and Arthur to start the Home Depot, but that was not enough money for the vision to be implemented in its original form. The two founders wanted to start with $25 million of new funds, so Home Depot started out undercapitalized and remained so for some time.

While Bernie and Arthur were developing the plans for what became Home Depot, someone else actually opened a warehouse home improvement store which was close to being the Home Depot model. As noted earlier, Pat Farrah opened that store in the greater Los Angeles area in January, 1978. When Bernie and Arthur discovered Farrah's store they considered buying it and going into business with Farrah. But a closer look revealed that Farrah's business lacked adequate financial controls. It was achieving unheard of sales volume yet losing money. It had already accumulated substantial debt, so Bernie and Arthur chose not to make the purchase. They did, however, want Farrah to join them, so they encouraged Farrah to simply close his store and join them. Farrah went bankrupt a short time later and then went to work for what became Home Depot. His merchandising talents would turn out to be one of the secrets to Home Depot's subsequent success.

An interesting footnote to Farrah's story is related by Marcus and Blank. Farrah felt guilty about losing the money of the investors in his bankrupt store. Consequently, when Home Depot went public, Farrah used a portion of his proceeds to pay back the original investors. In total he gave back $415,000 in the form of Home Depot stock (Marcus and Blank, p.64).

HOME DEPOT OPENS FOR BUSINESS
IN ATLANTA: June 22, 1979

Implementation of the plan then became the task of a three-man team: Marcus, Blank and Farrah. Working closely with them was Ron Brill who had been fired from Handy Dan because of his association with Marcus. Marcus held the title of chairman and chief executive officer with 18 percent of the common stock and Blank took the title of president with 15 percent. It was understood that Farrah would receive an amount of stock almost equivalent to that of Blank once Farrah had fulfilled his obligations under the bankruptcy proceedings of his old store. Farrah's role, once the stores were open, would be that of chief merchandiser. Ron Brill would perform various financial management functions including maintaining tight controls on office expenses. Bernie would later say of Brill (Marcus and Blank, p.246):

> *"Our greatest secret weapon in the battle against costs was Ron* (Brill). *He just always said no. You had to have a compelling reason to spend The Home Depot's money. If you made a good case for something he might open the purse strings."*

The first challenge facing the team was to determine where to locate the first new warehouse store. There were two dominant criteria. First, because the long run goal was to create a national chain of stores, the headquarters location and that of the first stores would have to be one which would attract high quality employees. Second, because Home Depot was undercapitalized the first location would have to be a city where the company could find adequate existing buildings. These criteria led the team to narrow the candidate sites down to four - Atlanta, Boston, Dallas and Los Angeles. Atlanta got the nod because of the availability of two stores which the Zayre Corporation was trying to sell.

The Home Depot story is laced with serendipitous developments, one of which had to do with the plan to acquire the Zayre stores. While working on plans to acquire the Zayre stores, Arthur heard a rumor that J.C. Penney might be willing to sublease space in some of its Treasure Island discount stores. Those stores had better locations than the Zayre stores so the Home Depot team immediately began to pursue the possibility. Following a colorful process of negotiations, Home Depot signed leases for space in four Treasure Island stores in the Atlanta area (Marcus and Blank, pp.66-69). That was two more stores than Marcus and Blank wanted to begin with due to limited capital for inventory and other start-up costs.

The next obstacle in the way of the grand opening was financial. Home Depot needed a large line of bank credit in order to purchase inventory and cover start-up costs. Ken Langone tried and failed to line up a bank or group of banks. In desperation Bernie turned to the bank he had used while running Handy Dan -- Security Pacific National Bank in Los Angeles. More specifically, he turned to Rip Fleming, the Security Pacific officer with whom he had worked in his Handy Dan days. With a persistent sales effort Bernie convinced Fleming to recommend that the bank authorize a $3.5 million loan. But Fleming had trouble getting the bank to approve. In fact, the bank's loan officers turned the proposal down three times. Fleming then threatened to resign from the bank if the Home Depot loan were not approved. Fleming had $400 million of accounts that would probably leave with him. The bank's loan officers made the Home Depot loan and were thereby able to hold on to Fleming (The rest of this story is colorfully told in Marcus and Blank, pp.73-78).

The actual name for the new business was not chosen until after the firm had solved the location and financing problems. A consultant was hired to help with the process and he came up with "Bad Bernies Buildall." That wasn't acceptable to the bank, so the founders asked their investors group to come up with suggestions. Marjorie Buckley produced a list which included "Home Depot". While the founders weren't totally enthused with this name, they decided it was good enough.

The Home Depot held its grand opening in Atlanta on June 22, 1979. The immediate response was not encouraging. A very small number of customers appeared the first day and in the weeks that followed the turnout was well below Bernie's and Arthur's expectations. They attributed the slow buildup of traffic to a cultural factor. As they saw it, home improvement customers in Atlanta had established personal ties with smaller, higher price stores in Atlanta. Breaking those ties was not easy, but eventually the Home Depot began to overcome that inertia. Bernie thought a key moment occurred when J.C. Penney decided to close the Treasure Island stores which operated in the same facility as Home Depot. Penney offered unbelievably low prices as part of the going-out-of-business sale. A huge number of people came out to take advantage of the

Penney sales and in the process became acquainted with Home Depot and its unbelievably low prices.

At the end of 1979 Home Depot had three stores open with 200 employees (called associates) and sales of $7 million. Home Depot reported a loss of almost one million dollars the first year. The company lost one-half of its capital reserves that year in order to cover the negative cash flow (Marcus and Blank, p.179). But by the end of 1979 the founders thought they were on the way to profitability. They were right. Home Depot made a profit of $856,000 in 1980 and almost doubled that number the following year. Nineteen-eighty was also the year that Home Depot opened the fourth store in the Atlanta area.

GOING PUBLIC AND EXPANDING NATIONALLY

Once the company founders were convinced their idea would work, they turned their attention to finding the funds for a nation-wide expansion. The financial results of nineteen-eighty provided enough evidence of viability to encourage the founders to make a public stock offering. The public offering took place in 1981. Home Depot offered 750,000 shares at $12.00 each. One-half of that money would go into the operation of the business. Bernie Marcus, Arthur Blank and Pat Farrah then sold enough of their stock to pay off their personal debts (Bernie sold 73,000 shares for $8.7 million; Arthur and Pat each sold $6.5 million worth of stock).

The most pressing reason for the public offering was to make it possible to open four new stores in Florida. On September 3, 1981 Home Depot stores opened in Ft. Lauderdale and Hollywood, Florida before the stock sale. Two more Florida stores were opened shortly after the public offering. Unlike the initial openings in Atlanta, the Florida openings attracted large crowds from the beginning. One reason, according to Bernie Marcus, was an unbelievable deal on ceiling fans. Arthur had arranged to offer $49.95 fans for only $29.25. The cost to Home Depot was $27 so the markup was minimal. But the irresistible bargain drew crowds of Floridians.

Home Depot consolidated its gains in the Atlanta and South Florida markets through 1983. When the year ended the company had 19 stores in operation, was generating $250 million in revenue, and was profitable.

Then the next phase of expansion began. In 1984 the company bought land in Los Angeles for future expansion and began looking for sites in Houston, San Diego and San Francisco. In October of 1984, Home Depot bought a Texas home improvement chain called Bowater Home Centers. That purchase turned out to be a major short run mistake, but it did give Home Depot six stores in the Dallas-Ft. Worth area (plus some stores in Louisiana) and eventually that beachhead became profitable beginning in 1986 (Marcus and Blank, p.185).

Once Bernie, Arthur and Ken Langone recognized the short run costs of the Bowater acquisition they decided to institute a policy to prevent future decision-making errors based on hubris. They asked the board of directors to establish a company policy restricting the rate of new store openings to a maximum of twenty-five per year. The board passed the motion (Marcus and Blank, p.185).

Even with a more realistic goal of twenty-five new stores per year Home Depot needed capital. The founders turned once again to Security Pacific National Bank. Home Depot's champion there, Rip Fleming, retired in 1983, but he recruited and trained his replacement, Faye Wilson. In 1985 Wilson put her career on the line in advocating a line of credit of $200 million. That loan was approved and, according to Marcus, it "..literally saved our company." In other words, the line of credit made it possible to grow Home Depot from a chain of fifty stores to one with one hundred stores (Marcus and Blank, p.187).

The expansion then took place at a rapid pace. Most new geographical markets were entered with only minor changes in the Home Depot formula. But there were some exceptions. One was the Northeast which Home Depot entered in 1988-91. Here is how Bernie remembers that challenge (Marcus and Blank, pp.196 -198):

> *"As a company we didn't change our general business philosophy, training or operational practices to enter the Northeast, but we were forced to radically reexamine our approach to merchandising in volume and **that** changed the company a lot. The stores we opened there did many, many times higher volume than even we were accustomed to...*
>
> *"In the South, we would sell 60 electrical receptacles and then order 72 more. In the Northeast we needed a thousand of the same item. So then we went back to the vendors and said,' We will no longer buy these in 48-packs. .. We want you to bundle up a thousand of them at a time."*

In 1994, Home Depot became an international business when it acquired a 75 percent interest in a Canadian home improvement store company. The chain was owned by the brewery company, Molson Companies, and it had six stores open with three more under construction. The Canadian chain was not profitable when Home Depot acquired it and it took two years for Home Depot to upgrade the stores to Home Depot standards. (Marcus and Blank, pp.200-201).

STRATEGY AND OPERATING POLICIES

As Home Depot expanded across the United States the founders simultaneously sought to stick with the founding principles while adjusting to local conditions. The four co-founders were convinced that the founding strategy would work anywhere. Hence it is appropriate to take a closer look at the strategy and basic principles.

CUSTOMER SERVICE AND TEACHING

Customer service is a mantra of virtually every business. What distinguishes outstanding businesses is their ability to actually provide superior service as opposed to simply giving lip service to the principle. Bernie, Arthur and Pat were convinced that they could motivate rank and file employees to provide exceptional service. Ken Langone was convinced that the three could deliver on that promise. The best place to learn what Bernie, Arthur and Pat were trying to do is to read the chapter on this subject in the Marcus and Blank book (2002, pp.132 -144).

One of the key strategies regarding customer service was to define the concept and then manage to make the definition a reality. Bernie's definition of customer service was (Marcus and Blank, 2002, p.134):

"1. *The right assortment*
2. *The right quantities*
3. *The right price*
4. *Associates on the sales floor who want to take care of customers*
5. *Associates who have been properly trained in terms of product knowledge*
6. *The expectation that our associates will be there when the customers need them."*

The key to exceptional customer service, as suggested above, was thought to be the associate on the sales floor. As Bernie put it (Marcus and Blank, p.l33):

> *"Our lifeblood is the associates in the stores. They are the people who work by the hour for wages. The cashier that just started can destroy our company. The lot engineer who loads the cars is the last person who has contact with the customer. If that person offends the customer in any way, shape, or form, he or she can destroy our business. We are painfully aware of how integral each of these people is to our survival."*

Another key cited by Roush was the combination of hiring people with the expectation that they would have a long career at The Home Depot and discouraging opportunism by shunning sales commissions. As Roush put it (p.21):

> *"Marcus has never liked paying commissions for sales because he feels that commissions give workers the wrong incentive. Instead, Marcus and Blank train workers to be sure that the customers get the right products for their needs, whether it's a 59-cent nut or a $59 power tool. 'The day they lay me out dead with an apple in my mouth is the day we'll pay commissions, 'says Marcus. 'If you pay commissions, you imply that the small customer isn't worth anything' ".*

But Home Depot did not dump all of the responsibility on the associates. All company executives, including lawyers, were required to work in the stores when they first joined the company. Arthur and Bernie made it a point to periodically work in the stores throughout their careers. And, of course, Pat Farrah was always in the stores.

Regular experience in the stores was regarded as an important way to keep the focus of non-store executives on Home Depot's core competencies. Bernie once compared this approach with Ed Telling's leadership at Sears, Roebuck in order to explain how Sears lost its competitiveness in the home repair and improvement market (Marcus and Blank. p.132):

> *"Years ago I read **The Big Store**: **Inside the Crisis and Revolution at Sears,** Donald R. Katz's behind-the-scenes look at Sears, Roebuck. It had a big effect on me, and for a number of years, I insisted that every executive in our company read the book. "*
>
> *"**The Big Store** told the story about how one particular chief executive of Sears, Ed Telling, hated to be in the stores. And that was apparently why he took the world's most revered retail company into virtually every other business under the sun... Sears bought all these other businesses that diluted its abilities and energy, and management neglected its core business. I wanted our people to read that book so that they understood how important our core business is. Telling hated the stores and that was where the bread and butter was coming from. That paid his salary. He never understood that ...*
>
> *"(A)t Sears, they sat up above it all in that ridiculous tower of theirs in Chicago . ...They never had a clue as to what was going on in their stores because they never spent time in the stores."*
>
> *"Arthur and I go into the stores alone and walk around, talking to customers and associates on the sales floor, learning what's really important to The Home Depot."*

Marcus and Blank regarded teaching as an essential part of the sales associate's job. Each encounter with a customer was an opportunity to help the customer learn about new products and new methods which might better meet the customer's needs than what the customer initially planned to buy. This was not simply a method designed to induce the customer to trade up to higher margin products. Indeed, every Home Depot associate was trained to recommend less expensive ways of doing the job. The thinking was that the customer would appreciate such a helpful approach and become a trusting, loyal Home Depot customer.

The idea that Home Depot should teach customers about products and methods led to the logical conclusion that the company should put on short "classes" for customers. As Bernie explained it (Marcus and Blank, p.137):

"Because we hired an army of trained plumbers, electricians, and other craftspeople as associates, organizing the How-To Clinics was a natural development for the stores. Our people were already instructing weekend warriors in an informal way. Putting on How-To clinics became a way of formalizing the teaching and making it available to all of our customers and further cultivating their interest in do-it-yourself home improvement."

Bernie likes to cite two additional corporate level policies that help to cement customer loyalty. One is a very liberal money-back guarantee. It is supposed to be an extremely liberal no-questions-asked approach. And because of this policy the sales associates are encouraged to, 1) encourage customers to buy more than they may need because, 2) they can return whatever they do not use.

A second corporate policy that is believed to have raised the level of customer service is the customer support service. This involves a telephone number that a customer can call in order to lodge a complaint. Here is the rest of that story as related by Bernie (Marcus and Blank, pp.142-143):

"The number went into our main office switchboard in Atlanta. ...The call would be directed to Arthur, Pat, me or whoever was the highest-ranking person in the company available at the time of the call.

"It didn't matter if we were signing a million-dollar deal; we stopped and took the call. We wanted our people to get to the right people and get their problems resolved.

"Word got around very quickly that you don't let a customer leave a Home Depot store unhappy because if that customer called (the customer service number), *the next phone call would be from one of us to the store."*

EMPLOYEE (ASSOCIATE) RELATIONSHIPS

Employees were called associates. That term was the founders' attempt to make it clear not only that running the business was a team effort, but more importantly that each employee should feel empowered to do what was necessary to satisfy the customer. As Bernie and Arthur put it (Marcus and Blank, p.105):

> *"To us 'associate' implies an equal as opposed to a wage slave. That's important because of the company's inverted management structure: We value what the salesperson on the floor says just as much - sometimes more - than what a district manager says, if they're right. That's because the salesperson touches the customer more."*

To attract and hold superior associates, Home Depot paid a competitive average wage plus a premium for sales performance. In addition, every employee was encouraged to become a company owner either through a 401(k) plan or a stock purchase plan. The stock purchase plan allowed employees to purchase stock at fifteen percent below the going market price. In addition, the company bought the stock back at what the employee paid if the price of the stock fell below its investment cost.

In the beginning the working hours were unbelievably long for many conscientious management employees. Then Marcus and Blank discovered cases of employees working twenty-four hours at a stretch. They put a stop to that by decreeing that no one could work at the store past midnight and that store managers and their assistants should not work more than an average of 55 hours a week.

In the beginning Home Depot developed a "macho" culture that simultaneously energized the average male employee and created the conditions which culminated in a sex discrimination suit. Wild celebration parties occurred at all levels - in the store, among the buyers group, and at company-wide management meetings. Bernie and Arthur put it like this (Marcus and Blank, pp.126-127):

> "(*I)n the early days, we were much wilder and carefree than we could ever get away with today. Almost anything went back then.*
>
> *"There are hundreds of stories of outrageous behavior from our early days, stunts, pranks and parties that slipped into corporate lore as The Home Depot grew into adulthood.*
>
> *"We weren't generally a party to such things, but on the weekends it wasn't unusual for our associates to throw some pretty wild beer parties once the last customer went home and the doors were closed. Music would be cranked up on the PA system, six-packs of beer and stacks of hot pizza would appear, and then - it was back to work.*

> *"While this would never be tolerated today - for one thing we are alcohol-free at all stores as well as at all official company functions - it was the norm then. Maybe it was a tradition handed down from Pat Farrah's Homeco days, when he was just a chain-link fence away from beer at all times.*
>
> *"There was so much work to do almost around the clock that certain allowances were made...*
>
> *"We were a small company and a tight-knit unit. Parties were often the celebration of another week's survival and preparation for the next week at war."*

As Home Depot grew Bernie and Arthur began to question the wisdom of that macho culture, particularly the use of alcohol. As they put it (Marcus and Blank, p.130)

> *"By the early 1990s we saw the destructive nature of alcohol. We had a couple of Christmas parties where we were especially troubled by it. We realized that the hard-drinking example set by the senior officers of the company was encouraging the same behavior in our young associates. Suddenly it didn't seem as much fun or romantic.*
>
> *"We discussed the situation and, as parents ourselves, agreed we no longer wanted to encourage this behavior or be seen as champions of recklessness...*
>
> *"Internally, going dry was considered one of the worst calamities that could ever strike the company... But after some time passed, most people understood why we did it. It changed the nature of the company's internal image, from one of gunslingers to a quilt of families. And where associates had stopped bringing their families to company parties, now everyone comes."*

The sex discrimination suit was probably an inevitable result of, 1) the macho culture, and 2) the fact that associates were largely recruited from the construction trades and only 2.6 percent of America's construction trades labor force was female. The class action suit against Home Depot was filed in 1994. It alleged a pattern of discrimination against women at the company. Bernie and

Arthur initially decided to fight. They knew the principles they operated by were non-discriminatory and they couldn't believe that a systematic policy of discrimination had developed. But the company decided to settle after being assigned a judge who was expected to be extremely unfair in handling the case. The settlement cost was $100 million (Marcus and Blank, p.126). Arthur and Bernie found that settling was emotionally draining because they didn't feel that the company as a whole had done anything wrong. But they came around to accepting it as a good thing in the sense that it prodded the company to put in place programs which would make the company a better place to work for women, minorities and older people. They convinced themselves of this with such reasoning as the following (Marcus and Blank, p.126):

> *"Companies today need to be aggressive and pro-active in creating an all-inclusive environment because discrimination does exist. It should really be done for two reasons. One, because it is the right thing to do, and that is what our best instincts in society demand, and two, a growing company needs an all-hands-on-deck environment."*

One other macho cultural trait stood out at the top of the organization and presumably appeared with some frequency at lower levels. That was the low level of civility combined with a deep level of support and respect in some decision-making situations. Here is how Roush describes one such upper level example in which the Home Depot's lumber buyer presented his budget to top management and Arthur Blank proceeded to argue with him in a most uncivil manner. However, that same evening the lumber buyer received a call from Arthur who said (Roush, p.28):

> *"I was brushing my teeth, and I was looking at myself in the mirror and wanted to let you know something. I wanted to find out how strongly you felt about what you were putting in your budget. All the yelling and shouting was in that direction. I respect you. I didn't want to go to bed without telling you that."*

The undercurrent of love and support is one of the values held most dearly by Bernie and Arthur. Both had occasionally experienced the opposite in their careers, most glaringly in their relationships with Sigiloff at Handy Dan, and so they took great personal pride and satisfaction in their assessment that (Marcus and Blank, back of dust jacket):

> *"I have never had anybody work for me in retailing who didn't work for me out of love, as opposed to fear. We carried this approach into building The Home Depot. We care about each other and we care about the customer. The things we do for customers inside and outside the stores demonstrate our commitment to them. And then when something happens within the company, we circle the wagons. We help each other"*

The superficial level of uncivil talk combined with a deeper level of love and support is reminiscent of the culture instilled in Leo Burnett, Inc. by its founder. It appears to be a characteristic of a subset of excellent American companies, and it appears to be a company culture classification which can inspire exceptional loyalty from persons with exceptional talent and an ability to thrive in a high stress, high achievement environment.

In the early days the company culture was strongly influenced by Pat Farrah. He was in the stores all of the time and while there he was constantly demanding change. Here is the assessment by Bernie and Arthur (1999, p.90):

> *"Pat Farrah was an absolute wild man, bigger than life in the early days of The Home Depot... He was passionate, and he shared his passion easily. He really drove the business from the store side, raising hell, stacking stuff up and slapping things off the shelves. But Pat was also the one in there restocking alongside the associates late at night.*
>
> *"He set the tone for everybody working in the stores, inspiring the same incredible loyalty and respect that he had at National Lumber and Homeco. It was because of his devotion, knowledge, and personality that our associates overlooked his less attractive traits.*
>
> *"When Pat was in a store or an office, there was a buzz, an indescribable energy. He made our wildest dreams believable."*

Within the general Home Depot culture there existed a sub-culture among the company's buyers (or merchants as they were called). This was Pat Farrah's area of responsibility and his own personality shaped the buyer subculture. In hiring merchants Home Depot focused on their ability to get the job done. Odd personalities were irrelevant. As a result, the corps of Home Depot buyers was filled with colorful, unconventional and sometimes obnoxious personalities. Pat's job was to teach the merchants how to do the job and to keep them motivated and focused. As Bernie and Arthur put it (Marcus and Blank, p.218):

> *"If you want merchants who chase deals like Dobermans, they are going to bite people once in a while. Pat's role with the merchants was to take this energy, both positive and negative, and tame the men and women who were too aggressive, juice those who were not aggressive enough, build the confidence in the neurotic ones and control the ones who were overconfident."*

Pat demanded total commitment to the company and that included inhuman hours. This eventually became a problem both for Pat and the merchants (buyers). Bernie and Arthur began to see it as a problem when one of the top buyers resigned because, as he put it, "I can't take the strain of keeping up with (Pat) anymore." (Marcus and Blank, p.207).

Pat Farrah's unsustainable pace finally led him to leave the company for his own health and that of The Home Depot. That occurred in 1985 when the company had 31 stores. Bernie and Arthur regarded it as one of the saddest, but most necessary, days. They knew they would miss him and that he would take with him some of the motivating excitement that fueled the company's early growth, but they also saw this as a necessary milestone. As they put it in their company history (p 208):

> *"In many ways Pat Farrah's departure in 1985 marked the Home Depot's coming of age. Whenever Pat was around, there was controversy. Life was never quiet and peaceful. The air was always electric, and after he was gone we had to generate more of our own electricity. We missed him, but we also proved to ourselves that we could still run the business, even if it wasn't as much fun without him. We came to understand that the culture we created was bigger than any one person...*
>
> *The next ten years saw unbridled and virtually unrestrained expansion... We developed mature operational systems and settled into life as an unqualified retail success, both in the aisles and on Wall Street."*

Bernie and Arthur kept in close touch with Pat after he left. By 1995 Pat was ready to come back to The Home Depot. The co-founders wanted him back for a couple of reasons. In their words (Marcus and Blank, p.210 -211):

> *"Sales per square foot and sales per store were up dramatically in the ten years he was away. We had also seen improvement on gross margins and in the lowering of our costs of buying product. In fact, from 1985 to 1995* everything *got better*.
>
> *"...But in terms of creating a spark, building the training environment, having a vision - we wanted that from Pat. .. We simply had not been able to duplicate many of Pat's strengths. He was such an unusual guy.*
>
> *"We also became a little fat, a little arrogant... That would never have happened on Pat's watch.*
>
> *"We gave our merchants too much latitude, only to learn that in certain categories, our competitors - even smaller companies - were getting better deals than we were. We needed a revival of aggressiveness in dealing with certain vendors."*

And so Pat Farrah returned. He came back fully realizing that he needed to be more patient and disciplined. He came back accepting certain controls designed to prevent him, from among other things, purchasing too much inventory. But he also came back with his motivational and training skills still intact. As Bernie and Arthur summed up the result (Marcus and Blank, p.213):

> *"Pat brought a lot of the old culture back, the hands-on feeling. He is a wonderful motivator. He has trained our merchants and gotten them back to basics, which, the bigger we become, the more they need to do."*

PRICING, ASSORTMENT AND EVERYDAY LOW PRICES

The Home Depot had a clear definition of the kinds of merchandise it would offer. The three criteria were (Marcus and Blank, p.222):

"1. The product had to be relevant (essential) to home improvement (or the equivalent for a business).
2. The Home Depot had to be able to dominate sales of the line in the market(s) it served.
3. The Home Depot had to be able to achieve "top-of- mind awareness" for the line. That meant that customers would think first of The Home Depot when they thought of where to buy the product."

The original target customer was the home owner with some business expected to come from the small handyman or craftsman. Later the company began an effort to expand sales to professional customers..

One of the keys, perhaps the single most important key, in The Home Depot strategy was to offer unbelievably low prices. One condition for being able to offer low prices was to negotiate low prices from the manufacturer. Eventually that would become relatively easy to do because of the huge volume that The Home Depot achieved. But in the beginning the volume wasn't that large and the company wasn't yet that credible. And so the company's buyers, including the founders, had to resort to a larger menu of sales techniques. As Bernie puts it (Marcus and Blank, dust jacket):

> *"We had to be psychologists, lovers, romancers, and con artists to get vendors aboard. Our ability to paint a picture of how that would take place - lowest prices, widest selection, and great customer service - was what convinced skeptical manufacturers to sell merchandise to us during the early years."*

Marcus and Blank devote an entire chapter to dealing with manufacturers, or, "strategic partners." Their colorful report is well worth reading, even by seasoned purchasing executives (and scholars).

In the early years of The Home Depot the company used sales promotions as a primary pricing strategy. Then a serendipitous development led the company to adopt everyday low pricing. Here's how Arthur Blank tells that story (Marcus and Blank, pp.152-153):

> *"Over the years, despite being competitors in several departments, we became good friends with Walton* (Walmart founder Sam) *and Glass* (Walton's successor David) *In 1993, Glass told* ***Fortune*** *magazine that The Home Depot runs, 'the best retail organization in America today'. We feel very comfortable picking up the phone and talking to them about general retail conditions...We often walk through each other's stores together, sharing ideas and taking notes. We are tough but friendly competitors on a very high level.*
>
> *"So it should not be too surprising that while visiting Wal-Mart's corporate headquarters...Walton convinced Bernie to try everyday low pricing at The Home Depot."*

Bernie brought the idea back for discussion. After careful analysis of the pros and cons the executive leadership agreed to make the change. There still remained a tough job of selling the store managers on the idea. As Arthur put it, "They *lived* for sales." (Marcus and Blank, p.154). Following an extensive communication campaign with the stores, the company switched to everyday low pricing in 1987. Both the associates in The Home Depot stores and the company buyers were still apprehensive, but the switch had a happy ending. The results were what Bernie and Arthur expected. That is (Marcus and Blank, p.155):

> *"Everyday low prices forced us to lower prices across the board, but because of that we were able to sell more of everything. As customers became confident that our prices were always good, we saved on advertising and better controlled our margins."*

LOCATION POLICY

Another policy that held the promise of lowering costs IN THE LONG RUN was the company approach to the lease or buy decision in the case of land. Bernie and Arthur wanted to control this aspect of each local operation by purchasing the land ahead of time (presumably at a better price). While this policy increased capital needs it also promised to give the company some cash flow flexibility once the financing had been completed.

OPERATING PROCEDURES

Between them Bernie Marcus and Arthur Blank were seasoned retailers. They had a proven track record in the home improvement industry BEFORE starting The Home Depot. Nevertheless, they did not saddle the new company with a set of "cast-in-concrete" operating procedures. Instead, their approach was to start with a set of procedures they thought would work but plan to make continuous improvements as they went along. Eventually they developed the following fourteen point operating philosophy which they present in their 1999 company history (Marcus and Blank, pp. 237 - 274):

1. The invisible fence - Operating authority should be decentralized in order to stay close to the customer and be receptive to information from the field. The degree to which authority should be delegated should vary with the local situations and the local management's capabilities. An invisible fence marks the limits of local authority. Local managers are encouraged to take responsibility to the limits of that fence and are expected to occasionally hit the fence.
2. The three bundles - Authority comes in three categories of bundles. First, there are a small number of things that have to be done the same way across the company. Second, there is an entrepreneurial "bundle" of responsibilities which requires adherence to a very broad company standard while allowing wide latitude in terms of meeting the standard. Third, there is a bundle of responsibilities for which local store managers have complete autonomy.
3. Hire people who are overqualified with a view toward growth in the future.
4. Have a financial conscience - Maintain tight financial controls.
5. One-man shows don't work.
6. Communication - "We must communicate to our stores why we do the things that we do and let them understand the logic behind our actions. The day they think we are stupid is the day we are dead in the water... So we periodically need to get in front of our associates and talk to them."
7. Bernie's Test - "Bernie has a little test to see how long it takes for an associate to recognize him... If he walks around a store for 45 minutes or an hour and no one recognizes him, he knows there is a problem in the store... nobody has looked in his face... They haven't acknowledge him... And he knows, as a result that we must have a bad manager and an even worse store."

8. 360 Feedback - "Our - 360 Feedback' is a way of providing Home Depot officers and managers with insight into their leadership style. The primary purpose of 360 is for the development of Home Depot leaders. It is not the same as a performance appraisal because it focuses primarily on leadership skills and is not tied to salaries or bonuses. However, performance appraisal and 360 degree are used together to help determine what kind of management development and which job assignments make the most sense.
9. Establish ties that bind - "I have looked for opportunities to build on my relationships with our senior officers and smooth the transition between me and Bernie. Participating in Outward Bound's team-building experiences have encouraged within us the ability to communicate sometimes without even saying a word. Those outings build trust, because trust is all you have on trips into the rugged middle of nowhere..."
10. Shut up and show them what you want - "One of the most important issues we face ... is producing enough qualified people to run and work in all the new stores. We want these people to carry on the Home Depot values... We think it's important enough so that this message is personally delivered in every training class. The week-long classes for assistant managers, managers and district managers start with me and end with Bernie."
11. Kill bureaucracy
12. Hire the best.
13. The inverted pyramid - "If we broke down the management structure at The Home Depot on a blackboard, Bernie Marcus and Arthur Blank would be at the bottom; the stores would be at the top."
14. Respect for the individual.

CULTURE AND COMPETITION

Bernie and Arthur believed in competition --- hard, but ethical competition. Sometimes the corporate culture seemed a bit rough on the competitors. Roush deals with this topic in several areas, concluding that, on balance, the company is to be admired rather than castigated. Among other comments, Roush tells us (1999):

> *"At sales meetings in the late eighties and early nineties, managers cheered cartoons of Homer, the company handyman mascot, visiting competitors in hospital beds and unplugging life support systems."*

Later in his study Roush tells the following story (pp.120-121):

> *"In August 1997 a Home Depot catalog in Chicago attacked competitor Menard, Inc. The mailing told customers to avoid buying 'knock-off' products and those of 'an inferior quality.' The catalog inferred those 'inferior' products could be found at local Menard stores because Menard wasn't selling Husky tools and lights from Lithonia Lighting. Responded John Menard, 'I don't think taking a big swipe at your competition is the proper thing to do. It seems a bit ungentlemanly'... A Home Depot spokesperson noted the catalog was in response to Menard ads. In February 1998, however, Menard filed a complaint with the National Advertising Division of the Council of Better Business Bureaus Inc., challenging Home Depot's claims. The council sided with Menard in September 1998, and Home Depot agreed to change its advertising policies."*

COMMUNITY INVOLVEMENT

Community service has become a hallmark of The Home Depot for idealistic and practical reasons. The idealistic reason is periodically presented by the founders as a welcome obligation of their Jewish faith. In their words (Marcus and Blank, p.275):

> *"When The Home Depot went public we realized that we had the financial capacity and wherewithal to give back to the communities where we did business. There is a concept in Judaism called* **tzedaka** *which means 'to give back.' It is considered a mitzvah, a good deed, to give to someone who doesn't have, and we believe strongly in giving back to the community."*

The practical reason is the good deeds are good business in the long run. They generate positive publicity for the company and a feeling of belonging to a worthy organization on the part of the employees.

The list of community service activities is long and varied. Each individual store is encouraged to undertake community service activities that meet local needs. The company estimated that about 30 percent of Home Depot employees nationwide were involved in community service in the mid 1990s. The officer providing the estimate went on to say, "That's how we develop our leaders" (Roush, p.137).

There have been some nationally prominent single incident examples of groups of stores providing emergency service to communities; Home Depot's response to the Federal Building bombing in Oklahoma City is one. The Home Depot district manager for the area took it upon himself to donate $70,000 worth of merchandise needed by the rescue workers. Another example occurred in December 1997 when Home Depot stores in Toronto, Canada sent six truckloads of supplies and volunteers to ride through Ottawa neighborhoods helping people fix the damage from a fierce winter storm.

Three programs supported nationally by the company deserve mention. A program called KaBOOM encouraged local stores to provide volunteer labor and materials to build local playgrounds. Another, Christmas in April*USA encouraged stores to organize volunteer home repair programs for "low income and disabled inner-city home owners." Home Depot also became a national sponsor of Habitat for Humanity. The company insisted on providing not only money but also volunteers, training, and materials.

Home Depot's community service resulted in several national awards. The company received a Community Builder Award (from the Christmas in April program), the 1995 President's National Community Service Award (beating out 3,000 other candidates), a Business Ethics award from *Business Ethics* magazine, and a Presidential Award for Sustainable Development. The latter award recognized the company's attempt to find suppliers who used environment - friendly practices.

SUCCESSOR MANAGEMENT and

REDEFINING THE CUSTOMER BASE

In 1997 Bernie and Arthur devoted a significant amount of time thinking about strategic changes necessary for continued rapid growth. They concluded that there was still much room for growth in the core business but that for continued growth the company should also move in four directions: increased sales to professional customers, international expansion, specialty-store expansion, and convenience stores.

It was also in 1997 that Bernie handed the CEO title to Arthur. Bernie remained as a highly visible chairman. Arthur served as CEO for four years. During that time he and Bernie became convinced that The Home Depot's next stage of growth would require the kind of discipline made famous by Jack Welch at General Electric. So they hired one of the candidates to succeed Welch, Robert L. Nardelli. Nardelli became Home Depot's CEO in December 2000.

There was little doubt in the founders' minds that Nardelli was the right choice. As Bernie said (Pascual, 2001):

> *"He's got the GE discipline, and he brought it to us. And we needed it."*

In fact, the co-founders were so anxious to attract Nardelli that Arthur stepped down as CEO rather than staying on for a transition period while Nardelli served as president and became familiar with the company. A few months later, effective May 30th, Arthur also resigned from the board of directors because he believed his presence was making it difficult for Nardelli to be fully accepted. As Arthur put it (Terhune, p.B10):

> *"A founder casts a long shadow. I didn't realize how long a shadow it was until someone else was in the room with us. People would still check my temperature on a lot of things. I felt that it wasn't the right thing."*

Things did not go as well as hoped for Nardelli in his first two years at the helm. He did what he was brought in to do. Costs were cut, controls were tightened, and new performance measures were introduced. Margins improved and so did cash on hand. The balance sheet remained strong. But a suddenly stalled national economy and general sharp decline in stock prices caused Home Depot's sales growth to slow and its stock price to fall. Competition in the form of a newly energized Lowes also presented problems. On January 17, 2003 a critical article appeared in *The Wall Street Journal*. Investors and an unidentified number of Home Depot employees were reported to be unhappy with Nardelli's leadership, but the article gave no indication that the founders felt that Nardelli had been the wrong choice. In fact, Ken Langone was quoted as saying (Morse, 2003):

> *"We think Bob is doing a superb job and is making the changes going forward that are necessary."*

It seems clear that the company co-founders were correct in concluding that a changed business environment called for a new leader with skills appropriate to the new challenges. And it is to their credit that they were willing to step aside to give the new leader the authority needed to achieve corporate renewal. Only time will tell whether or not they chose the right individual to succeed them.

REFERENCES

1. Hagerty, James R. "A Free Spirit Energizes Home Depot," *The Wall Street Journal,* April 11, 2000, p. B1., B4.
2. Marcus, Bernie and Arthur Blank with Bob Andelman. *Built from Scratch.* New York: Random House, 1999.
3. Morse, Dan, "A Hardware Chain Struggles to Adjust To a New Blueprint," *The Wall Street Journal*, January 17, 2003, pp.A1, A6.
4. Pascual, Aixa, "Tyding Up at Home Depot," *Business Week*, November 26,2001, pp.102-104.
5. Roush, Chris. *Inside Home Depot.* New York: McGraw-Hill, 1999.
6. Terhune, Chad, "Home Depot Founder Blank Quits Board To Clear Path for Current CEO Nardelli," *The Wall Street Journal*, February 22, 2001, p.B10.