

# Home Depot Strategic Challenge

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## **EXECUTIVE SUMMARY**

Since the beginning of his tenure in 2000, Home Depot CEO Robert Nardelli made strategic decisions for the home improvement giant that resulted in large short-term returns. With these short-term returns came long-term consequences. Now, shortly after fourth quarter 2006, these consequences are coming to fruition and Home Depot's profitability is at an all-time low. Nardelli retired January 3, 2007 and was replaced by vice chairman Frank Blake, who is faced with the challenge of improving profitability for shareholders. What new strategic decisions can Blake pursue to solve these managerial problems?

Home Depot ("HD") must refocus on its core competencies to restore shareholders' confidence. HD and its major competitor, Lowe's, compete primarily on customer service, and based on recent surveys, Lowe's has been exceeding HD in this department. This is primarily due to Nardelli slashing HD employees' benefits and hours as well as replacing knowledgeable full-time employees with part-time employees. HD must restore employee morale. In addition to this, HD must maintain its broad product differentiation and keep its focus on its retail business by selling off its supply division.

## **HOME DEPOT FACES HARD TIMES**

Home Depot has been through many changes in the past five six years, including a structure realignment to streamline decision-making, enhance in-store execution, and further improve customer service that occurred October 2006. Another major event for the company is the resignation of CEO Robert Nardelli on January 3, 2007 after seven years of service with the company. Nardelli was replaced with vice chairman Francis (Frank) S. Blake at this time. Nardelli's departure was due to pressures from shareholders deciding his compensation package

was too generous compared to the “weak stock performance, slowing profits, and a regulatory probe about its operations practices.”<sup>1</sup> In fact, the net income of fourth quarter 2006 dropped 28% since the previous year, signifying the largest quarterly profit drop in a decade.<sup>2</sup>

At one time during Nardelli’s tenure Home Depot’s stock performance was at an all time high. What happened during this six-year period for stock valuation to drop so low? The strategic management problem at hand is that Nardelli lost sight of Home Depot’s core competencies which consist of their:

- Retail stores
- Customer service
- Low Prices and wide range of products

Their supplier segment is becoming a distraction for Home Depot away from their retail stores, poor employee benefits, decreasing full-time employees and increasing part-time, and hiring unknowledgeable staff is preventing the home improvement giant from gaining market share. Home Depot must return to its core competencies to restore its performance in the marketplace.

## **HOME DEPOT SUPPLY**

Home Depot Inc. is the largest home improvement retail chain, carrying around 50,000 assorted home improvement products. They operate more than 2,150 stores in all 50 US states as well as some stores located outside of the region in areas such as Canada, the District of Columbia, Puerto Rico and Mexico.

Home Depot (“HD”) launched its separate division, HD Supply in 1997, which caters to the professional builders in the construction industry. HD Supply operates about 1,000 locations

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<sup>1</sup> Kavilanz, Parija B. (2007, January 3). Nardelli out at Home Depot. [CNNMoney.Com](http://money.cnn.com/2007/01/03/news/companies/home_depot/index.htm). Retrieved from the Internet February 27, 2007: [http://money.cnn.com/2007/01/03/news/companies/home\\_depot/index.htm](http://money.cnn.com/2007/01/03/news/companies/home_depot/index.htm)

<sup>2</sup> “Home Depot Inc. (HD).” [Yahoo! Finance](http://finance.yahoo.com/q?s=HD). 27 February 2007. Retrieved from the Internet February 27, 2007: <http://finance.yahoo.com/q?s=HD>

across the nation and also distributes a variety of building materials/tools, providing installation services to businesses and the government. Due to its rapid expansion, HD has suffered losses in its primary retail business because of its focus on its Supply division. However, this is a problem because although HDS has generated a lot of business, their returns are significantly lower.

## **DECLINING CUSTOMER SERVICE**

Home Depot has three major retail competitors: Lowe's, Menard, and True Value. Lowe's however, is a direct competitor of Home Depot. With a high degree of rivalry and being the second largest home improvement chain, they are successfully expanding. Lowe's currently is operating more than 1,300 stores in 49 states, but unfortunately have not gone international like their #1 competitor Home Depot.

Due to the overall market slowing down and HD's lack in quality customer service, its biggest rival, Lowe's, has been stealing much of their market share. John Parsons of Shreveport, LA owns a 50-year-old house that needs constant repair, and for years he was a regular customer of a nearby HD store. About a year ago, he switched to a Lowe's store, even though it is farther from his house, because he received better service there. "The people at Home Depot don't want to talk to you," he says. "They hide or they say they're busy."<sup>3</sup> Perhaps this slacking quality of customer service is due to big changes in employee policy during Nardelli's term. One former employee of Home Depot stated that the company began slashing benefits and would only begin to hire part-time—and cheaper, unknowledgeable—labor as well as increasing the employee-to-customer ratio. Customers quickly became frustrated with the lack of adequate service at a store

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<sup>3</sup> Zimmerman, A. (2007, February 20). Home Depot tries to make nice to customers. The Wall Street Journal. Associated Press Financial Wire. Retrieved February 25, 2007 from the Internet: <http://www.wsj.com>

that was once known for its knowledgeable staff.<sup>4</sup> Nardelli was trading long term stability for short term gains by cutting costs. Despite these problems with customer service, HD insists that they are committed to a valuable workforce within the company:

Over the years it has become clear that one of our key competitive advantages is our associates and the diversity of thought and cultural background they bring to the workplace. That withstanding, the Home Depot seeks to build a workforce that reflects its communities. We believe that diversity is the catalyst for innovative thinking, entrepreneurial spirit and new ways of building our communities. We are convinced the greater the diversity of our people, the greater our ability to serve our customers and communities.

*Marlon Sullivan*  
*HD Senior Director of Staffing*<sup>5</sup>

Due to the shrinking consumer demand and lack of new market space, competition between the existing retailers is fierce. The incumbent firms each have a large financial stake to protect and are eager to dominate their existing space and prevent new-comers from entering. They have begun to differentiate based on things such as customer service where before they only had to provide a larger selection of products. Lowe's has been taking away market share from Hd based on this attention towards customer service.

## **WHAT WILL HELP AND HINDER HOME DEPOT'S MANAGERIAL EFFORTS?**

HD will continue to have strong marketing efforts to reach out to their retail customer base. The company is the "'official home improvement sponsor' of the National Football League" as well as continuing to be an official sponsor of NASCAR. HD is branching out across

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<sup>4</sup> McCormack, C. (2007, February 27). [Personal interview with Josh Edwards].

<sup>5</sup> Older Americans Act. CQ Congressional Testimony. (2006, April 3). CAPITOL HILL HEARING TESTIMONY, 1031 words, HOUSE EDUCATION AND THE WORKFORCE, MARLON SULLIVAN, SENIOR DIRECTOR OF STAFFING, THE HOME DEPOT. Retrieved from the Internet February 27, 2007.

cultures to new sports as it becomes the "Official Home Improvement Retailer" of the Mexican National Team and its 2004 U.S. soccer tour.<sup>6</sup>

HD maintains a partnership with SAP AG, "the world's leading provider of business software solutions." This symbolizes HD's move to create standardized systems and platforms to create a stronger IT infrastructure throughout the company. The enhanced infrastructure will strengthen HD's retail operations and support other growth businesses HD decides to take on as well as improving overall efficiency.<sup>7</sup>

To be in direct competition with Home Depot a firm must set up a large scale retail business offering a wide variety of products and services. Currently this is not an easy feat to achieve. The major players in this market segment (HD and Lowe's) grew rapidly as a result of the housing boom of late 90s and early 2000s. This boom has slowed nationwide over the past couple of years which has directly affected sales related to home improvement. Furthermore, this market is dominated by the major players and even they are struggling to find new geographic areas to open new retail outlets, so barriers to entry for the home improvement market are high. "Home Depot is running out of room to build new stores in the United States, which is why, in 2000, Nardelli began cobbling together Home Depot Supply."<sup>8</sup>

There are a few factors that are enhancing or challenging the way HD makes changes within its environment. For example, President Bush has spoken out that "Government should not decide the compensation for America's corporate executives, but the salaries and bonuses of CEOs should be based on their success at improving their companies and bringing value to their

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<sup>6</sup> Oberman, E. (2007, January 9). The Home Depot Becomes an Official NFL Sponsor. [HomeDepot.Com](http://www.HomeDepot.Com). Retrieved 24 February 2007 from the Internet: <http://ir.homedepot.com/releasedetail.cfm?releaseid=224939>

<sup>7</sup> Smith, P. (2005, May 18). The Home Depot Partners with SAP to Accelerate the Company's Technology Strategy. [SAP.Com](http://www.SAP.Com). Retrieved from the Internet 24 February 2007: <http://www.sap.com/industries/retail/newsevents/press.epx?PressID=177>

<sup>8</sup> Barbaro, M. Home Depot weighs spinoff of supply business. [The International Herald Tribune Online](http://www.TheInternationalHeraldTribuneOnline). Retrieved 24 February 2007 from the Internet: <http://www.ihf.com/articles/2007/02/13/business/depot.php>

shareholders.”<sup>9</sup> This supports the reasoning for the shareholders to lay off Nardelli. The following are more areas in the PESTEL model that affect HD’s managerial decisions:

### **Economic**

- The Home Depot Supply has not been showing much profits in comparison to the retail division<sup>10</sup>
- Home Depot may have expanded to its limits in the US<sup>11</sup>

### **Socio-Cultural**

- Home Depot had been employing knowledgeable customer service in each area of the store: a carpet expert in the carpet area, plumbers in plumbing, etc. until the culture at HD changed to uneducated customer service providers.

### **Technology**

- Finding partners that use new technology to help HD continue to sell products.<sup>12</sup>

### **Environment**

- Eroded employee morale<sup>13</sup>
- Nardelli pushed to lay off established employees<sup>14</sup>
- The public is angry that they have been paying the president, Nardelli, so generously while the stock was not performing well.<sup>15</sup>

## **STRATEGIC RECOMMENDATIONS**

Nardelli was trading long term stability for short term gains by cutting costs, namely costs associated with customer service. He began replacing full time and knowledgeable staff with part time employees—and less employees overall. We recommend that HD focuses on

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<sup>9</sup> Hamilton, W. (2007, February 1). Nation's chief exec enters CEO pay fray. *Los Angeles Times*. P. 1.

<sup>10</sup> Home Depot might offload supplies division RETAILING; [LONDON 1ST EDITION] [ANDREW WARD. Financial Times](#). London (UK): Feb 13, 2007. pg. 24

<sup>11</sup> Dukceovich, Davide (2003, Feb, 2 ). Home Depot Finds The World A Small Place . *Forbes.com*, Retrieved Jan, 20, 2007, from [http://www.forbes.com/2002/03/21/0321homedepot\\_print.html](http://www.forbes.com/2002/03/21/0321homedepot_print.html)

<sup>12</sup> [Plumb & Square, The Home Depot's Service Provider, Goes Live With ClickSoftware for Mobile Workforce Optimization](#), PR Newswire US, November 2, 2006 Thursday 4:32 PM GMT, , 990 words, BURLINGTON, Massachusetts November 2

<sup>13</sup> [HOME DEPOT'S NEW HR LEADER FACES TALL ORDER](#), Workforce Management, February 12, 2007, OUT FRONT; Pg. 4, 569 Wörter, Gina Ruiz

<sup>14</sup> [HOME DEPOT: LAST AMONG SHOPPERS](#), Business Week, June 19, 2006 Correction Appended, News: Analysis & Commentary: THE CUSTOMER; Pg. 34, 656 words, By Brian Grow, with Susan McMillan, in Atlanta <[http://web.lexis-nexis.com/universe/doclist?\\_m=cc39438cf5c9be6833bd4f9aff77d1c6&wchp=dGLbVlz-zSkVA&\\_md5=b3869b90dcc8b0dbc364e5a77cf640d2](http://web.lexis-nexis.com/universe/doclist?_m=cc39438cf5c9be6833bd4f9aff77d1c6&wchp=dGLbVlz-zSkVA&_md5=b3869b90dcc8b0dbc364e5a77cf640d2)>

<sup>15</sup> [Opinion Poll](#), Investment News, January 29, 2007, OPINION POLL; Pg. 2, 89 words.

increasing its employee morale first and foremost, especially because HD and Lowe's competes primarily on customer service. The retail chain can begin by training their employees to be more knowledgeable about products offered. They should hire more employees to be on hand at any given time, and most of the new hires should be full-time specialists in a certain area of home improvement. Benefits prior to Nardelli's induction should be restored.

Home Depot should continue with their Broad Differentiation strategy, maintaining a product range that is more diverse than their closest competitor, Lowe's who has 40,000 products to Home Depot's 50,000 products. This will allow Home Depot to attract a more a client base that is looking for varied products.

Finally, HD must return to its roots and focus on its retail business. Most consumers turn to HD as primarily a retail store and not a supply resource. In order to achieve this, HD must sell off, spin off, or initiate an IPO of its supply division.<sup>16</sup>

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<sup>16</sup> Dayhoff, D. The Home Depot Announces Strategic Evaluation of HD Supply. [HomeDepot.Com](http://ir.homedepot.com/releasedetail.cfm?releaseid=229509). Retrieved from the Internet 28 February 2007: <http://ir.homedepot.com/releasedetail.cfm?releaseid=229509>