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THE CORPORATION


Home Depot: Thinking Outside The Big Box

The home-improvement giant ratchets up growth -- by moving past the lumberyard look

Early last year, beleaguered store managers at Home Depot Inc. ([HD](#)) were drowning in paperwork. Endless communiqués from national, regional, and district headquarters bombarded them with demands

to change a kitchen display or to restock screws. "We'd get a fax, an e-mail, a call, and a memo, all on the same project," says Michael A. Jones, former manager of a Home Depot in Thornton, Colo. Even staffers back at headquarters in Atlanta saw how ridiculous things had become. One exec managed to wallpaper an entire conference room -- floor to ceiling, windows included -- with just three weeks' worth of memos.

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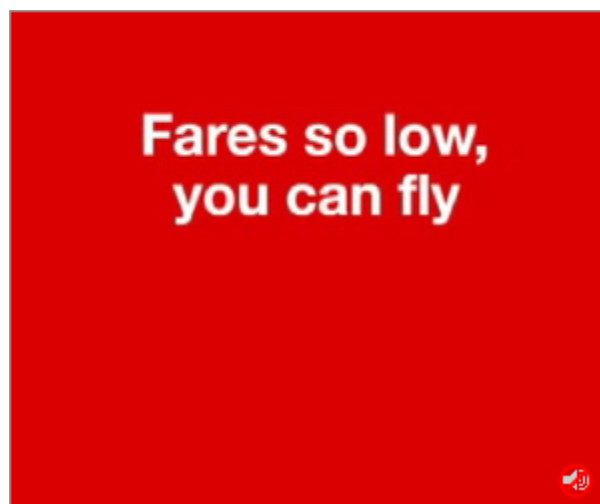
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When store managers complained to Chief Executive Robert L. Nardelli about the paper blizzard in March, 2003, he moved fast to stamp out one of the last vestiges of the company's old lumberyard style of management. He told his top managers to ax duplicate communications and streamline work projects. Directives not related to work orders had to be sent separately and only once a month. Meanwhile, the company spent \$2 million on workload management software. Today, that system automatically blocks new work orders if current tasks are still on the docket. And in rigorous Nardelli fashion, when a to-do list for managers arrives electronically, it is marked in green. If it isn't done by the set date, it changes to red -- and district managers can pounce.

Nardelli, former head of General Electric Co.'s (GE) Power Systems unit, is remaking Home Depot, and doing it in classic GE style. He's betting big on technology to boost productivity while plunging into services, this time to profit from those who want home improvements done for them. There is also a push to innovate, with spiffy new store designs, and a move into largely untapped foreign markets, such as China, where the company is scouting locations.

A REAL REVAMP

Altogether, it's an approach that relies less on hawking hammers and nails from 150,000-square-foot orange boxes, and more on carving out lucrative new niches in the home-improvement market. Despite being pummeled early on for dismal customer service and weak earnings, Nardelli has stuck to his strategy. In the past three years he has spent \$2 billion on technology, including inventory-management systems and Web-based kiosks in stores that offer shoppers access to thousands of special-order items. Those upgrades helped raise operating-profit margins by 0.8% in the second quarter, to 12.3% (compared with 11.7% at archrival Lowe's Cos. (LOW)), according to Lehman Brothers (LEH) analyst Alan M. Rifkin. Meanwhile, the push to sell services, such as kitchen and bath installation, and a higher-margin mix of house-brand and national-brand goods, also has perked up profits.

The bottom line: Analysts and investors believe the \$65 billion home-improvement giant -- which ranked No. 22 on this year's BusinessWeek 50 list of the best-performing large public companies -- is at last regaining the form that made it an innovator during the '80s and early '90s. In the second fiscal quarter, ended Aug. 1, revenues rose 11%, to a record \$20 billion, helped by the boom in home construction and remodeling. Profits climbed 19%, to \$1.55 billion, exceeding Wall Street's expectations. Home Depot's average sales ticket rose 8% from a year earlier, to \$54.73, as consumers shrugged off rising gas prices and interest rates to stock up on everything from patio furniture to \$1,000 GE Adora refrigerators. Lehman Brothers' Rifkin thinks that revenues will top \$72 billion in fiscal 2004, with profits of \$4.9 billion. Meanwhile, the stock is trading around \$40, a 52-week high.

Just as important, Nardelli is finally easing out the ghosts of co-founders Bernard Marcus and Arthur M. Blank. The legendary pair developed Home Depot from a single Atlanta store in 1978 into a chain that epitomized big-box success. But by the time Nardelli took over in December, 2000, Home Depot had lost its competitive edge. Its stores looked like lumberyards, while Lowe's had modern stores and carried upscale goods aimed at women shoppers, rather than Bob Vila wannabes. "Arrogance breeds complacency, and complacency breeds failure," says Nardelli. He began undoing part of the Marcus and Blank legacy by centralizing purchasing to achieve economies of scale, and he made sure inventory was restocked outside store hours, to allay complaints about messy aisles. And, of course, he attacked the paper blizzard that was burying his store managers. Says Kenneth G. Langone, a Home Depot co-founder, director, and, with 17.5 million shares, its second-largest individual stockholder: "There's no doubt that Bob Nardelli is the spiritual leader of Home Depot now."

Like many other GE alums, Nardelli relies on reams of data to drive innovation. To figure out how to design the new Manhattan store, for example, executives conducted 400 telephone surveys with New Yorkers, and 200 with local contractors. The result: a gleaming, two-story, 105,000-sq.-ft. operation with 7% of



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its floor space dedicated to closet designs -- for those tiny city apartments -- and a kitchen and bath department so popular that it now has a five-week wait for appointments. And those Web-based kiosks are expected to become self-service, credit-card checkout counters as soon as next year. Look for more variations on this theme: Of the 185 new stores that Home Depot plans to open this year, one-fifth will depart from the traditional big-box layout. "In 2005 and beyond, new stores will be designed for the neighborhoods that they are in," says Chief Financial Officer Carol B. Tomé.

Nardelli still has his work cut out. Lowe's, with its bright, clean stores, remains Wall Street's home-improvement darling. The 1,019-outlet chain has led the industry in total sales gains, on a percentage basis, every quarter except one for the past three years. Its stock price, now at \$54, has more than doubled in the past four years. That's a sore point for Home Depot execs. Although the company's stock has almost doubled in price since the beginning of 2003, it is still down 9% since Nardelli took over.

One reason for the lagging stock price, say analysts, is that investors are still doubtful that Nardelli can deliver sustained profits, after years of neglect. What's more, with the shift toward services, some analysts find it more difficult to predict Home Depot's profits accurately. Determining margins on 27 different types of at-home installations, or custom interiors, is far trickier than using traditional sales-per-square-foot figures. And while services were just 5% of sales in 2002, they could total 15% of sales by 2010, according to UBS Securities. ([UBS](#))

Even now, Home Depot is pushing the limits of customer service. Its techies are toying with using projected human images, like those in the Steven Spielberg film *Minority Report*, as sales tools. At the touch of a button, they would pop up, say, on the side of a dishwasher or refrigerator to offer tips about the appliance. They could begin showing up in some stores as early as next year. But unlike those ghosts, Nardelli's makeover appears rock solid.

By Brian Grow in Atlanta

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