The Home Depot Considers Entering China

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In the early 2000s, Home Depot faced both a major business opportunity and significant challenges as it considered potential strategies for expanding into the rapidly expanding Chinese market.

History

The Home Depot was founded in 1978 by Bernie Marcus and Arthur Blank. In June, 1979, they opened their first store in Atlanta, Georgia, offering comprehensive one-stop home improvement shopping, primarily for the "Do It Yourself" (DIY) market. Thus, their primary target customer was a homeowner who needed tools, materials and potentially, advice on how to complete a home project, for example, building a deck or installing a toilet.

The stores sold building, plumbing and electrical supplies, plus a wide assortment of hand and power tools, including both national and proprietary brands in models suitable for everyone from the home handyman to professional contractors. They also stocked lawn and garden equipment and supplies and extensive seasonal assortments of live plants and landscaping materials. Later, Home Depot added home appliances, both large and small.

The first warehouse-style stores were larger than anything previously available in the market, with approximately 60,000 square feet of floor space (over 6500 square meters) and 25,000 items (SKUs). The store size has grown even more since then, with the average store size being 105,000 square feet. (See the Appendix of this case for additional information about the current size and operations of the company.)

They prided themselves on providing top-notch customer service; the best in the industry by their reckoning with their sales associates providing hands-on instruction and in-store workshops on topics such as hanging wallpaper, laying tile, framing a wall, etc., for their homeowner customers. Their advertising pointed out that many of their sales associates were in fact experienced plumbers, electricians or other craftsmen who were experts in what they sold, plus they provided extensive training to other associates.

The Home Depot has also been quite successful in providing a mix of well-known national brands and its own proprietary products, for example, RIDGID tools and Behr paints.

As noted, throughout most of its history, and notably while the founders ran the company, The Home Depot has prided itself on its customer service, the expertise of its staff, and the way its people are treated. In his memoir, "Built
From Scratch", Bernie Marcus says, "At the end of the day, we're in the people business."

**A Record of Growth and International Expansion**

The Home Depot has been one of the fastest growing retail businesses in U.S. history. It went public in 1981 and was originally listed on NASDAQ, moving to the New York Stock Exchange in 1984. During the 1980s and 1990s, the company grew rapidly, opening its 100th store in 1989.

As of the second quarter of 2010, the company had grown to be the world's largest home improvement retailer, ranking as the fourth largest retailer of any type in the U.S., and the fifth largest retailer in the world. As a further mark of its rapid growth, it is the "youngest" retailer in the Fortune 500. The Home Depot operates more than 2200 retail stores in the U.S., Puerto Rico, the U.S. Virgin Islands, Guam, Canada, Mexico and China, with 268 international operations accounting for 11.9% of the store base.

As it continued to expand into new markets, and to add stores (and market share) in existing markets, Home Depot also looked across international borders for further growth. Despite a tentative, and ultimately unsuccessful step into Chile and Argentina (from which they withdrew in 2001), there were other success stories.

Home Depot expanded first into Canada with its acquisition of Aikenhead home improvement centers in 1994, and by Q2 2010 operated 179 stores in 10 Canadian provinces. The Canada stores catered to several customer groups, including DIY, "Do It For Me" (DIFM), and home improvement/maintenance professionals. They also provide in-store design centers, offering advice and services such as consultation on home improvement projects, and computer-assisted design for kitchens and decks.

Home Depot followed its Canadian market entry by its acquisition of the four-store TOTAL HOME chain in Mexico in 2001. The following year, it acquired another four-store home improvement chain, Del Norte, and then a much larger acquisition of the 20 locations of Home Mart, at that time the second largest home improvement retailer in Mexico, in 2004. The Home Depot Mexico is now the leading home improvement retailer in Mexico.

The Canada and Mexico expansions were ultimately much more successful than the company's South American experiment. While the shared borders of these two countries likely reduced the impact of national boundaries and distance, the more probable success factor was the method of entry. Home Depot learned an important lesson in Argentina and Chile in deciding not to simply importing the same business model to a distant market.
The expansion into Canada and Mexico was accomplished though the acquisition of similar, existing companies, already well-established in these markets. This brought an understanding of cultural and other unique features of these markets, as well as established customer relationships. Home Depot was careful to not quickly impose its own complete business model on these acquired companies, but rather to build on their strengths, while bringing systems and other operating efficiencies and processes that allowed them to build on their success.

However, the company also had further expansion in its sights. By the start of the new millennium in 2000, the Home Depot was actively looking toward an even bigger global market --- the more than one billion people in the exploding market of China.

Why China?

There are many reasons why companies from around the globe are looking to China as a significant growth opportunity. Many mature retail markets have become quite saturated with retail stores and formats, with a good deal of competition centered on battles for market share rather than absolute growth. Even companies such as Walmart, McDonald's, and The Home Depot, which have created tremendous growth within their domestic roots have found the China market to be extremely attractive.

In one sense, China is hardly "new" to economic growth and development. Prior to the 1800's, China had grown to be one of the world's largest economies, though its growth flattened beginning in the 15th and 16th centuries, and even declining later in the 1800s and for a good part of the 20th century. Mao Tse Tung's Great Leap Forward and Cultural Revolution, that was imposed following the Communist defeat of the Nationalists in China in 1949, and continuing through 1978, wreaked havoc on what remained of the economy. Famine killed tens of millions of people and living standards were frozen at 1930s levels.

Following deposition of Mao's immediate successors in a coup, an incipient reform process was instituted. However, the first efforts at reform were spotty. There were some successes, including re-opening agriculture to other-than-state control, some cracks in the wall prohibiting foreign direct investment (FDI) and permission for small operators to set up their own businesses. Nevertheless, at least at the start of reform, most sectors of business and industry were held under direct state control and ownership.

Deng Xiaoping, then the Chairman of the Communist Party, initiated these early reforms in 1978. He focused initially on the agricultural sector, and the reformists' "Household-responsibility" system, creating private farms and gardens whereby farmers would keep the production of their land in return for a payment to the government. There were also reforms in other industries, including the reduction of
complete state control of production and distribution, establishment of private, entrepreneurial enterprise, and easing of price controls.

Perhaps most significant for U.S. and other foreign retailers and businesses, special districts were created to encourage business investment, and these zones developed into centers of rapid economic growth and expansion.

This loosening of central economic control expanded during the mid-1980s and early 1990s. Significantly, regional and local leaders began to play a greater role in economic development and decision-making. Besides the relaxation of state control, this development was also likely driven by the significant differences in regional economies, stages of economic development, and cultural differences that distinguish different parts of this large country and population.

Such reform did not occur without mishap, as China repeated a centuries-old pattern of economic and cultural reform, followed by political and social backlash. One of the most famous of these events was the Tiananmen Square protest of 1989 over rising corruption and price inflation, leading to a very harsh, conservative crackdown.

Nevertheless, the "cat was out of the bag", and reform efforts continued into the 1990s. Particularly starting in the middle part of that decade, all but a few of the large state industries were privatized. In addition, the process of reducing barriers to entry into China to do business (e.g., tariffs, changes in the baking system, etc.) accelerated, increasing outside interest in getting on board early as this economic train was accelerating.

The economic indicators were very favorable, and projected to grow at a rapid pace. For example, according to the U.S.-China Business Council, China's GDP in 2000 was 9,921.5 Billion RMB (approximately $1.5 trillion in 2011 US$), and growing at over 8% per year. Retail sales that same year were 3,911 Billion RMB (595 Billion in 2011 US$), and personal income, especially in urban areas, was growing at double digit rates. (Note: By 2009, it was clear that the rosy forecasts were true. GDP grew nearly every year between 200 and 2009 at annual rates between 8.3% and 13%, to a total amount of over 5.1 Trillion US$. By 2009, retail sales stood at 12534 Billion RMB, or $1.907 Trillion US$.)

The housing market in particular seemed to provide an attractive opportunity to The Home Depot. In contrast to the U.S., where home or condo buyers typically purchase a house that is essentially "finished", except perhaps for paint or carpet choices, in China, the situation is entirely different.

The apartment is essentially an unfinished shell. They are often without plumbing fixtures (or even pipes), wiring, cabinets, flooring (other than a concrete slab) doors or even walls. The customer is responsible for all of this finishing work. As The Home Depot's own web site describes it, the customer must:
1. Select a contractor, decoration, and finishing service
2. Develop a home design plan in conjunction with the contractor
3. Select and purchase construction materials through the contractor or in consultation with the contractor, or by the homeowner himself
4. Agree to the finishing schedule and pricing
5. Allow time (on average 2-3 months) for the work to be completed
6. Conduct the final check of the whole project when finished

Even people who happen to purchase an existing or a near completed home will presumably need some home related merchandise and services.

However, in contrast to the typical North American DIY customer, Chinese homeowners do not have a history of doing their own home improvement work. Instead, they typically hire someone else to do the work - a "Do It for Me" (DIFM) approach. Nevertheless, there was no question that with millions of people moving to the cities and buying homes, and the explosive growth of the market, someone was going to be selling a lot of home and building items, and The Home Depot saw an enormous potential opportunity. The question was, "If we conclude we can successfully compete in this new market, how and when should we -- or must we --make our move?"

**Choosing an Entry Strategy**

Talk of Home Depot entering the China home improvement market had been brewing for several years. The question of whether they would make a move seemed less to be "if" than "when".

B & Q, a unit of the British firm, Kingfisher PLC, an experienced leader in DIY stores, already had a head start on Home Depot, having opened their first store in Shanghai in 1999. B & Q had a somewhat rocky start in China, as they learned that the Kingfisher model in the UK did not seem to appeal to Chinese shoppers. These customers were used to interacting directly with the merchandise before buying, and were put off by having the merchandise stacked high on shelves. As Bloomberg Business Week reported in 2006, Chinese customers were even afraid to go very far into the store, in part because of the store design and because they were "intimidated by the prices of the most expensive goods, which Kingfisher/B & Q traditionally displayed at the head of each aisle." B & Q learned its lesson, placing items within easy reach and featuring bargains prominently. It redesigned its store to feature a visual look that is much "softer" than the typical warehouse (e.g., Home Depot) and offered items such as large fish aquariums not typically found in European or American homes, but favored by the Chinese. (By 2005, B & Q had 49 stores and $542 million in sales. Home Depot hadn't opened a single store by that time.)

B & Q wasn't the only competition. There were also established China-based
competitors, including Homemart, Orient Home and Homeway. Home Depot had actually had discussions with Homeway as early as the mid-1990s, though nothing came of it. However, Homeway did learn some tricks from Home Depot, adopting major aspects of its business mode, even the prominent orange aprons for employees!

Clearly, Home Depot needed to make a move if it hoped to compete in the China market. Prime locations, consumer attention, not to mention their juan were being captured by these other competitors. But how they would get in was problematic.

Should Home Depot export its tried-and-true - and successful - business model, store designs and processes to China? Should it seek a partnership or joint venture with one of the competitors noted above? Or should it simply acquire one of them?

In 2005, then CEO Robert L. Nardelli, who had taken the job several years earlier after leaving GE, described China as a major priority for the company, especially as a way to sustain growth in the face of a saturating North American market. Chuck Elias, then Home Depot's top manager in China had been quietly researching the market, visiting a wide range of cities, studying the markets and the competitors.

Depending on the entry strategy chosen, Elias and Nardelli knew they would face a number of difficult execution challenges, and given their rather poor experience at trying to run stores that were distant from the U.S. (such as Chile and Argentina), they knew that they had to have the right management team as well as customer-facing employees to be successful.

Getting the right people to lead the effort was central. But did they have them at Home Depot - predominantly a home-grown company? There were other questions:

- They had some good, experienced managers who "knew" the company and its operations, but could they transfer that capability to doing business in a country like China, where they probably didn't even speak the language?

- Would any North American based executives even want to go to China?

- Would it work if managers ran the China operation by "remote control" - traveling periodically to China to stay in touch, but depending on locally based managers to run the day-to-day operations? Would they ever truly get to know the market with a somewhat absentee management approach?

- Could local Chinese employees rapidly learn the Home Depot culture and
way of doing business? Would that have to change?

- How much training would be required, and who would do it? Since Home Depot wanted to transfer its success as a one-stop destination for home Supplies, (something these new homeowners clearly needed) how could it train staff to handle complete home finishing jobs?

- Would it be better to simply acquire an existing retailer and then try to merge the best practices of that company with those of Home Depot? How long would that take? What changes would be required in Home Depot's existing culture and practices? Compensation?

Considering what you have learned about China so far, what advice would you give to Home Depot's management? Should they pursue expansion into China, and by what method? How should they handle the many human resource challenges involved in putting a team in place? Can you think of other HR related challenges that have not been discussed here?
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Part 2: December 2006 and Forward

In its May 1, 2006 edition, the online magazine Bloomberg Businessweek featured a story titled "Home Depot: One Foot in China". The story asked, "The home improvement chain wants in - but is it being too cautious?", "When will Home Depot make its move?", and "Is Home Depot blowing it? Or is it biding its time for the right reasons?"

By this time in 2006, the mainland China home improvement market was seen as the most promising opportunity in the world. The market had exploded, with estimates at the time ranging from $15 - $50 billion in sales the preceding year (2005), and continuing to grow at a rate of 12% per year. Twenty years earlier, in the early-to-mid 1980s, there was virtually no home ownership in China, but that had grown to approximately 70% in 2006.

As noted earlier, The Home Depot's CEO, Robert Nardelli, had identified entry into China as a major company goal, but wanted to avoid the earlier Home Depot failures in Chile and Argentina, while capturing the successful approaches in Mexico and Canada. Yet as the clock ticked, other Chinese chains, including Homemart, Orient Home, and Homeway, the chain that literally modeled itself after Home Depot, with significant Home Depot support (beginning as early as 1996) - were building brand recognition, acquiring premier locations and establishing important vendor links. This added to the time pressure to make a strategic move, in order to avoid being effectively closed out of the market.

In December, 2006, the news network MSNBC announced that Home Depot had purchased Homeway for an undisclosed price, but one figure that some news reports said was $100 million. The announcement was made by Annette Verschuren, Home Depot's President for The Home Depot - Asia, who until the announcement had been serving as president of Home Depot Canada, based in Toronto. As reported in Canadian business Online on January 29, 2007, Verschuren said, "The great retailers of the world are multinational. They need to be in other countries and have an increasingly larger portion of their growth outside their home base." She went on to include other Asian-Pacific countries, including Taiwan, Indonesia, India and other potential markets.

At the time of acquisition, Homeway had 12 stores in six cities: Tianjin (5 stores), Beijing (2), Xi'an (2), Qinqdao (1), Shenyang (1), and Shengzhou (1). Yves Chen was named retail president for The Home Depot China.

By early 2009, just over two years after the Homeway acquisition, The Home Depot had a new CEO, Frank Blake. He offered a cautious assessment of Home Depot's progress in the China market in the interim. According to a Reuters news report on March 12, 2009, Blake told an internet consumer conference
sponsored by Bank of America - Merrill Lynch, "While we're pleased with the business performance, we're still not confident we have the right business model." In the same conference, he said further, and not surprisingly, that "We want to figure out how to make money there. We'll either figure it out or we won't be there."

In a personal interview with Raymond Chou in November, 2010, Managing Director for China Retail for The Home Depot, he recounted some background to the 2006 market entry decision, while acknowledging that he had not been involved at the time. Chou said that Home Depot had considered a "Greenfield" entry approach, literally bringing the existing Home Depot business model, store and merchandising approach to China and building from scratch.

However, he said, it was decided that a relatively small acquisition was the more prudent approach, and that Homeway was selected because it would be practical to integrate with the larger Home Depot organization. After all, since the mid-1990s, they had had an ongoing relationship, and that everything from the business design to the signage -- and even the orange aprons! -- were modeled after The Home Depot.

Nevertheless, the product assortment, brands, and other features of the store environment differed from the rest of The Home Depot stores elsewhere. Integrating these differences proved to be a challenge. The Home Depot wanted to teach the parent company's values, business approach and systems, etc., but also recognized that it had to adapt to Chinese needs and preferences, not least among them the need for a "build-out" capability for the bare-bones apartments that Chinese homeowners were buying.

One adaptation was working with partner contractors, where Homeway/Home Depot would certify and guarantee their work, a key in the Chinese "Do It For Me" climate. Chou said that the stores themselves were working to distinguish themselves in three important ways:

- Product - certainly quality, but also distinctive brands known for such quality (a challenge in a market where he pointed out that "brands" were not well established, and Home Depot's proprietary brands were unknown)
- Standing behind what they sell
- Providing the "Best" service

Chou said that establishing and extending product channel relationships had posed a challenge. Home Depot had established a team that combined representatives from the parent company, and people "inherited" from the acquired Homeway. By doing this it hoped to reap the best of both the large, international Home Depot expertise, and the more intimate knowledge of the Chinese market unique to the Homeway staff.
While all of these problems might be considered "normal" features of the complicated processes involved in the integration of a foreign acquisition, especially one in as complicated and dynamic environment as the Chinese one in this time period, there were other challenges.

Bloomberg.com reported in December, 2008, that the president of Home Depot China, Yves Chen, had resigned, after less than two years in the position. No reason for the departure was noted, except that it was for "personal reasons". He was replaced by Simon Chuen, who was formerly vice president for merchandising in China.

Home Depot's 12 China stores saw reduced revenue of 31 % for the quarter preceding Chen's 2008 departure, the first decline since the December 2006 acquisition. Home Depot CEO Frank Blake attributed at least some of the decline to the Beijing Olympics (in August) to the quarter that ended in October. Home Depot was not alone; B&O, which had more than 60 stores in China at the time, reported a 28.5% sales decline for the same period. Other sources reported a steep decline in real estate sales, attributed to a credit crunch and resulting overall property slump.

In the past two years (2009 and 2010), Home Depot's presence has been reduced to nine stores: 4 in Tianjin, 2 in Xi'an, and one each in Beijing and Zhengzhou, a drop of three stores from the original twelve.

The journal, China Business Focus, detailed the closure of the store in Qingdao, Shandong. The story began with Home Depot's acquisition of Homeway, or more specifically, Tianjin Jiashijie Group Home Corporation, in 2006. However, while Home Depot acquired the 12 stores' inventory and operating rights, the property rights were sold to Sunshine Estate, a property management company.

Since much of the action has been behind the scenes, it is difficult to know the precise details of store closures and other events. However, the Qingdao closing offers one example. Home Depot declared in a statement for the 21st Century Economic Report that the property managers in Qingdao gave notice that they planned a major reconstruction of the existing retail space, and wanted the store to close for a full year. According to their statement, Home Depot felt that it was "... nearly impossible to resume our business in Qingdao to its previous scale after one year." Other stores face similar "remodeling" challenges.

In November, 2010, when asked, "Can Home Depot 'win' in China?", Raymond Chou said, "Yes! Absolutely! They want the same things that we do in our homes .. "

As of early 2011, Home Depot operates 8 stores in China: 4 in Tianjin, 2 in Xi'an, one in Beijing (plus the corporate office), and one in Zhengzhou.
The Home Depot International Operations

The Home Depot* is the world's largest home improvement specialty retailer, with more than 2,200 retail stores in the United States, Puerto Rico, the territories of the U.S. Virgin Islands and Guam, Canada, Mexico and China. As of the end of the second quarter of 2010, our 268 international operations represent 11.9 percent of our store base.

The Company is already the largest home improvement retailer in Mexico, in addition to the U.S. The Home Depot entered Canada in 1994 and Mexico in 2001 through a combination of acquisitions and organic growth. Both markets are examples of how The Home Depot combines its vast knowledge of the home improvement industry with the needs, shopping trends and customs of each unique geography to best serve customers. In December 2006, The Home Depot acquired The Home Way, China's first "big box" home improvement retail chain.

Canada
Since 1994, The Home Depot Canada has been offering its customers the ultimate home improvement shopping experience for do-it-yourselfers, do-it-for-me customers, and home improvement construction and building maintenance professionals. The Home Depot Canada stores have design centers staffed by professionals who offer free in-store consultation for home improvement projects, ranging from lighting to computer-assisted design for kitchens and decks, as well as on-site Tool Rental Centers.

At-A-Glance
Leadership: Annette M. Verschuren - President, The Home Depot Canada and Asia

Number of Stores:
(Q210) 179 in 10 Canadian provinces (Alberta, British Columbia, Manitoba, New Brunswick, Newfoundland, Nova Scotia, Ontario, Prince Edward Island, Quebec and Saskatchewan)

Number of Associates: More than 27,000

Format: 60,000 to 150,000 square foot retail facilities with 15,000 to 25,000 square foot garden centers

Address: The Home Depot Canada 900 -1 Concorde Gate, Toronto, ON M3C 4H9

Mexico
In May 2001, The Home Depot entered the Mexico market through the acquisition of Total HOME, a four- store home improvement chain, from Monterrey-based ALFA, SA. In 2002, the company acquired Del Norte, a four-store home improvement chain. The Home Depot increased its presence in Mexico in May 2004, with the acquisition of Home Mart, the second largest Mexican home improvement retailer. Under that transaction, The Home Depot acquired 20 Home Mart locations. The Home Depot Mexico is the top home improvement retailer in Mexico.

-more-
At-A-Glance

Leadership: Ricardo Saldivar - President, The Home Depot Mexico

Number of Stores: 80

Number of Associates: approximately 7,144

Format: 54,000, 66,000 and 77,000 square-foot retail facilities with more than 20,000 products in each store

Address: Ricardo Margain 555 Edif. A Parque
Corporativo Santa Engracia
Garza Garcia NL, Mexico 66267

China

In December 2006, The Home Depot acquired The Home Way, China's first "big box" home improvement retailer. The Home Depot now operates 10 stores, which average 90,000 square feet of selling space, across five cities in China.

The Home Depot also has sourcing operations in China staffed by approximately 100 associates. The Company has been sourcing products in China, such as lighting fixtures, fans, flooring, bath accessories, faucets, hardware and tools for more than 10 years.

Leadership: Annette Verschuren, president, The Home Depot Asia
Yves Chen, retail president, The Home Depot China

Number of Associates: Nearly 100 in sourcing offices; 3,000 in newly acquired retail operations

Number of Stores: 9
China Home Improvement Market Overview

In December 2006, The Home Depot acquired The Home Way, China's first "big box" home improvement retailer. The Home Depot now operates 12 stores, which average 90,000 square feet of selling space, across six cities in China.

Leadership:
Annette Verschuren, president, The Home Depot Asia
Yves Chen, retail president, The Home Depot China

Headquarters: Tianjin

Number of Associates: Approximately 3,000

Number of Stores: 12, operated across six cities in China
   Tianjin (5)
   Beijing (2)
   Xi'an (2)
   Qingdao (1)
   Shenyang (1)
   Zhengzhou (1)

Store Format: Average 90,000 square feet

Services Offered: Delivery, installation, design and remodel services

The China Home Improvement Market
The home improvement market in China varies greatly from other parts of the world. In the 1990s, the government's reform of the housing system led to private homeownership, which is now a major trend and rapidly growing market sector in China. Through its acquisition of The Home Way, The Home Depot is bringing the world's leading home improvement merchandising and store operations capability to one of the fastest growing economies in the world.

The characteristics of the Chinese home improvement market creates a solid growth opportunity for The Home Depot, given the company's strength in merchandise and services geared to finishing out a home. In the United States, Canada and Mexico, The Home Depot has developed a core competency in installation services, especially in categories like kitchens, countertops, windows and other design services. In addition, The Home Depot's strength in identifying and offering innovative merchandise at low prices complements the current strategy of The Home Way. Quality installation services and innovative merchandise are the top needs of homebuyers in China.

Statistics:
- China now has one of the highest homeownership rates in the world. In just 20 years, Chinese homeownership has gone from zero to about 70 percent.
- China's GDP is nearly $1.5 trillion.* The country's population is growing, along with personal wealth.
- It is estimated that the Chinese home improvement market today is at nearly $50 billion* and growing at a compounded annual rate of 20 percent.

*Expressed in U. S. dollars.
Home Building in China:
In the major cities, homebuyers typically purchase an apartment that needs a range of finishing work. In many cases, after purchasing a home, Chinese consumers must:

1. Select a contractor for design, decoration and finishing service
2. Develop a home design plan in conjunction with the contractor
3. Select and purchase construction materials through the contractor or in consultation with the contractor or by the homeowner himself
4. Agree to the finishing schedule and pricing
5. Allow time (on average 2-3 months) for the work to be completed
6. Conduct the final check of the whole project when finished

Those consumers who buy a home where the finishing work has already been completed still need access to innovative home-related merchandise and services at attractive prices.

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