

Straight Talk

An Interview with Kenneth G. Langone,
Chairman, President, and Chief Executive Officer, Invemed Associates, Inc.
and Director and Co-Founder, Home Depot, Inc.

EDITORS' NOTE Kenneth Langone co-founded Home Depot in 1978 by raising \$2 million via his small investment bank, Invemed Associates. In 1957, Langone received a job in the investment department of the Equitable Life Assurance Company while obtaining his M.B.A. at NYU's Graduate School of Business (now the Stern School of Business). After graduation and a two-year stint in the Army, in 1961, Langone joined the Wall Street firm R.W. Pressprich & Co., where he eventually became



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an Executive Vice President and then President. Langone later founded the Home Depot along with Bernard Marcus, former CEO of Handy Dan. In 1974, Langone established his Park Avenue brokerage and investment banking firm, Invemed Associates. Langone has served as a Director for Home Depot, Inc.; AutoFinance, Inc.; Unifi, Inc.; and US Satellite Broadcasting of Minnesota and as a board member for New York Stock Exchange, ChoicePoint, YUM! Brands, Inc., InterWorld Corp., DBT Online, Inc., and is a member of NYU's Board of Trustees. Langone majored in economics and political science at Bucknell University.

COMPANY BRIEF Based in New York, Invemed Associates seeks to invest in buyouts and minority stakes in small-cap public companies, and also sponsors corporate orphans and start-ups. The firm focuses its investments in retail, medical technology, and technology companies, and does not use leverage to finance transactions. The firm retains portfolio companies for five to ten years. It prefers to exit its investments through an initial public offering.

Employing more than 300,000 associates and with 2,238 retail stores in all 50 states, the District of Columbia, Puerto Rico, U.S. Virgin Islands, Guam, 10 Canadian provinces, Mexico, and China, The Home Depot (www.homedepot.com; NYSE: HD) is the world's largest home improvement specialty retailer. In fiscal 2008, The Home Depot had sales of \$71.3 billion and earnings from continuing operations of \$2.3 billion.

When you look at the severity and length of the economic downturn, are you surprised, and do you wonder how we got this far?

I'm not surprised in the least for the simple reason that a nation cannot be so cavalier about issuing debt without concern for the consequences of that issuance. Certainly the powers that be deserve a lot of credit for addressing the crisis last fall. But now it's time for us to take a step back and say, the patient is now out of intensive care, let's think about a long-term program that restores the patient's health. One of the things I'm bothered by is that the stimulus package further pushes out the point at which we begin to

address the long-term issues we have to deal with. Once we came back from the abyss, we should have had the resolve to say, this is going to take us three to five years to get righted, and we'll deal with that. Now it's inevitable, whether we do it now or five or ten years from now, that we're going to have to address the issue of America living on extraordinarily excessive amounts of debt, both in the government and even more immediately with people and how they're living their lives with credit card debt, subprime debt, mortgage debt, car loan debt – you name it. You have to be willing to go without something now for the greater long-term good of you, the individual. I'm talking about changing habits, which is very hard to do.

Should we not have more effectively anticipated the economic crisis?

Sure. You had people buying homes they've never seen, that they couldn't afford to make the monthly payments on, and you had accommodating financial institutions that allowed them to do it. If one wants to buy a house, there is an intermediary supplying the money. This was a case of the little guy getting the big guy. Usually it's the little guy that suffers the mistakes of the big guy, but this time, the little guy was on a spending spree, and the big guys were walking all the way to the bank.

Do you agree with the premise that there are public institutions that we can't allow to fail?

Moral hazard works for individuals as well as for businesses. If you're running a company and you wantonly go into debt and keep adding to it, without any regard to the consequences of potentially bad days ahead, then you have to expect the punishment of failure. Once you take away that risk, then you really have no safeguards.

Some suggest that we're on the road to recovery. Do you believe we're near seeing the light at the end of the tunnel?

No, we've only pushed off the beginning of the recovery. You don't ask an alcoholic to stop drinking and give him a bottle of wine. It's inconsistent. We were the drunk on debt in terms of how we lived as a people and how we ran our government. What we've done now is to load on enormous debt with a stimulus package. So we still haven't begun the real recovery process. We only live right now with the sufferance of those people who are willing to buy our debt. History will tell you, that doesn't go on forever.

Many feel recovery is going to be led by private sector entrepreneurship and innovation. Do you worry that we're losing some of the entrepreneurial edge?

People have jobs, so they're educating their children, they're living in their homes, they're paying their mortgages off, and they either own a car or they're paying it off. Job creation is a fundamental cornerstone of democracy. Hitler could never have come to power except for the devastation of the German economy. The extent to which I've been encouraged by our society to do things to create jobs was stimulated by knowing that the more jobs I create, if I do it right, the more successful I become. It's like that old saying, "the rising tide lifts all boats." The fact of the matter is there always are, and always should be, winners and losers. As long as you have that system, it provides the greatest motivation people need because they don't want to be losers – those who are competitive want to be winners. It's important for enormous companies to avoid getting caught up in their own standing. No matter how big Walmart gets, it still functions to this day as if it was one store and if they don't have sales for a week, then they're going to go broke. K-Mart had a series of leaders that were status quo, and meanwhile, Walmart, Lowe's, and Target were crawling up their backs. Businesses are people, and businesses are led by people; nothing will ever change that. The first responsibility I have is to figure out a way to address an opportunity in a way that is good for me and for everybody else who's with me. Home Depot began with three people 30 years ago, and now, we have 325,000 people who have good paying jobs and career path opportunities, allowing them to educate their children, live in their homes, drive their cars, and enjoy the American life.

Could you have created Home Depot in today's environment?

No, because we believed that to get the esprit de corps at the store level, there had to be a feeling of ownership. The way we get our options today, we never would have made money and we never could have gone public and we never could have raised the money we needed. Are there abuses in issues of options? Yes, there are, but they have to be handled one on one; one size doesn't fit all. For instance, we gave out options at Home Depot 10 years ago at \$50 a share. If the current rules were in then, we'd have had to expense all that, and all those options would expire worthless, and cost us \$0.

Are you still optimistic that we can continue to build those leading companies in the future?

Look at Silicon Valley. IBM was kind of the mountain 30 years ago. Microsoft was a little pipsqueak that saw an opportunity in software. IBM literally gave them the business. Innovation is about seeing a human want or need and addressing it in a way that you can help. At the end of the day, Home Depot had three things: price, service, and assortment – it was that simple. Philosophically, we wanted a very bright line around what we did, why we existed. There were all these regional chains – Pergament, Rickles, Channel, Scottie's, and Payless Cashway, for example, and they all stayed in little areas. They were all getting 44, 45, 46 percent returns, so they were sitting ducks. In 1988, we hadn't opened our first stores on Long Island, and I went to Rickles for a broom and there was a sign saying that their policy was when there are more than four people in line, they would open up a new register. So I got on a line of seven people and nothing happened. The manager was in a glass enclosed office in the front of the store with a necktie on and I talked to him about the sign and he told me that most of the time, they would open a new register. I warned him that if our stores came in, that would be it for them, and that's what happened. There are businesses that haven't even been thought about, much less started, but you have to be realistic about the human want or human need, and be realistic about what it's worth and whether you can deliver it at the right price to make a profit.

Is that entrepreneurial instinct something you are born with or can it be developed?

I've always been in the service business. I caddied, which is a 100 percent service job. It used to be \$3 a bag, but you would hope to get \$3.50 or \$4 and you knew that incremental business would be as a result of doing a good job. Everything I did, I knew one thing: the better I treated the customer, the better I did. Everybody wants to be respected. Everybody wants to be catered to. And it worked because I always managed to do better with those accounts than my competitors. It was driven mostly by the idea of a good experience. But you don't go to college to learn that. A lot of people just don't care. Customers allow you to have a business; when you don't have customers, you don't have a business. That's common sense.

Many at the senior levels of large companies talk about the need to have an

entrepreneurial and innovative environment today. Can you truly implement that when you're dealing with a certain size and scale?

The car companies have been in trouble since WWII, because right after WWII, you could only have what they wanted you to have. They took an attitude that the customer was the enemy, so if you had a legitimate complaint, the position always was, it was a spurious complaint and disregard it. In 1984, I bought a Chrysler LeBaron convertible and had only put about 1,500 miles on it when one of the pistons holding the trunk lid open broke. I went back to the dealer to explain what happened, and he referred me to the district manager, who refused to help. So I vowed to never purchase a Chrysler product again and I have not. You have to make the effort. In the early days of Home Depot, we had people bring tires back and we were giving refunds. We never sold a tire at Home Depot in our entire history. But we had this belief.

In those times, there had to be a conviction among the three founders that was very consistent. How critical was that vision?

It was not just among the three of us; it was among every single person that came with us. First we had 20 people, then 50, then 100, then thousands, and then tens of thousands – it was always a belief that we had. And 10 years ago, we began to get away from that. But right now, we're infusing it back with a vengeance and the results are spectacular.

As the company has grown, how hard is it to keep effective control?

You start with the understanding that the further away you get from the customer, the less important you are. So the CEO is at the point of an inverted triangle because he's furthest away. He's got division presidents, regional vice presidents, district managers, store managers, assistant managers, department heads, etc. But leadership has a number of significant components: One, fairness; two, consistency or don't be a hypocrite, meaning don't ever ask someone to do something you're not willing to do yourself; and three, work with people to show them that they're capable of so much more than they think they're capable of. Leadership is by example. Treat people in a respectful, fair, caring way and they will respond; they will go the extra mile beyond where you want them to go. That to me is the measure of true leadership, to get people to do so much better than they thought they could do. The minute I've made so much money that I think I don't have to do that, that will be the time to get out of the business.

How do you work with your employees to make sure that the company's message gets through to them?

You never take anything for granted. You never assume somebody in the company knows what it's all about. Home Depot is now 30 years old, but we have always enforced the focus on customers first. We literally tell our employees that their first job is not down packing or fixing up a shelf. When you see a customer, attack. The service levels are coming back and the customers are responding. More importantly, the attitude of the people is improving, because they're starting to once again realize that they matter.

In terms of policy issues helping to spur innovation and entrepreneurship, does more need to be done? And can we get away from policies squelching some of this innovation?

Most of Home Depot's good ideas came from people on the floor. If you want to accomplish anything, you want to encourage people to bring forth ideas, even if they're bad ideas; and if they're bad ideas, don't disrespect them. Say, we tried, we looked at them, they don't work, and no hard feelings, but come back again and keep trying.

Public perception of business leaders is not very favorable today. Can and should more be done to get the message out about the good being done?

Human nature is such that those that have always done well are always suffering suspicion. There are people who think I'm a crook no matter how much good I do away from my business – that comes with the territory. I've always contended that if you don't like what you see in the mirror, you've got a real problem.

You have been very focused on community, but with so much need out there, how challenging is it to decide what to become involved in? Is it where you can have the most impact?

No. You have to have an affinity for what you do. I have always been around health care all my business career. I'm a great advocate of education, especially public education, because I went to a public school and all my education is very meaningful to where I am today; same is true with universities and colleges. I also believe selfishly that the more educated people there are in a society, the better chance there is to do a lot more and make a lot more money.

Regardless of the work being done, there is still a perception that the education system is broken. Are you optimistic about reform in this area?

You have an environment where no matter how much more you do, you don't get treated any differently than anybody else, so why make the extra effort? The problem with education is the quality in the teaching. There are societal issues like single families, and crime and drugs, but when a kid comes into a classroom, if the person presiding in that classroom doesn't know how to get the kid's attention and teach him something he didn't know, he's lost.

Are you of the belief we need to reform the health care system, and is the dialogue how you hoped it would be?

No. Health care is a challenging issue. What we need to do is drive incentives for being healthy. One's health should be one's primary responsibility. There is enough public health out there.

What would those who know you best say about Ken Langone's management philosophy and style?

You don't work for him – you work with him. Nobody works for you, everybody works with you. It's a common goal and a common effort.

Do you have a secret for your success? Yeah, be born with a high energy level ●