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Interview with Tom Stemberg

Staples

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Interviewer: Amy Blitz, HBS Director of Media
Development for Entrepreneurial Management

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TOM STEMBERG

The Early Years

I think, genetically entrepreneurs often pro-generate others. My dad was an entrepreneur. He ran a restaurant. So I guess I qualified on that account. It's often said as well that one shows entrepreneurial tendencies early in life, and I'd say my first entrepreneurial leanings were when I was at Harvard College. I got involved first with Harvard Student Agencies, the student-run million-dollar (at the time), and business in a variety of services, including the *Let's Go* travel series. Having grown up in Europe, working at Harvard Student Agencies was a logical thing for me to do. I grew in that organization, and eventually ran the *Harvard Independent*, which was my first quasi-entrepreneurial venture, and this was a relative start-up. It had been around for about five months when I stepped in as its second publisher, and it's still around today, something I'm very, very proud of. So I think early in my career I kind of knew I would end up running a business someday.

The HBS Experience

I'm not sure that we can always neatly categorize the contributions that the Harvard Business School makes to your success. To be sure, it's often the informal things, the mentorship from, in my case, individuals like Walt Salmon, who played such a huge role, and Ben Shapiro, a legendary marketing professor. They played a huge role in shaping my career and advising me when I was about to start a new business, which of course turned out to be Staples. And later on, there have been individuals like Bill Sahlman and Kim Clark who have helped in many ways. Your section-mates also contribute in many ways to your success over many years. Some of them have served as investment bankers or other forms of advisors. And I think that at the end of the day, the stuff in the classroom pays off too, though it's not nearly as obvious right away. I remember once discussing pricing structure in a certain industry with a particular chief executive, and I explained his problem as the Butcher Polish case, which was the original marketing case I had in school. And our company had exactly the same problem as this company did. So the HBS education does pay off a lot over time, I believe.

Finding the Opportunity

Starting your own company is always something one thinks about. I went to a larger company initially, and I still believe today that getting a fundamental orientation in whichever field you want to end up in makes a lot of sense. I pursued a career with the Jewel Companies, and they had a corporate training program that allowed you to advance very rapidly through the ranks, including cutting meat and running a produce department and running a front end and hiring and firing people, which was just terrific experience. Then I moved on to another grocery store chain called First National Supermarkets, where I became the president of the division. As they were selling the division out from under me, I had a disagreement with management and got fired.

That really was the seminal moment in starting Staples. The day after I got fired, the guys who fired me came back, having met with a prospective buyer, being one Leo Kahn, and said, “Tom, we told Leo that you’re not coming with the package, and he said you should call him right away; he wants to back you in a business.” It was nice to have a former competitor, a real giant within our industry, come up and say he wanted to be, in effect, my patron saint. And it’s worked out very well for both of us.

Leo and I went out and tried to buy a supermarket chain, and we looked very hard to buy a supermarket chain. Between Leo’s non-compete clauses and the economics of the business at the time, we just couldn’t find one. And Leo kept saying, “specialty retailing.” We would spend Friday afternoons looking at shopping malls, wholesale clubs, and other kinds of service operations, looking for ideas. We finally came upon office products. The idea was to apply the grocery store model—where customers do their own shopping—to office supplies. Leo said, “OK, let’s open up a store.” And I said, “Well, I don’t know. For you it’s an investment; for me it’s my career. Do you mind if we spend \$10,000 each on research?” And we each threw in \$10,000 and hired a former teaching assistant of Walt Salmon’s, who had run the market research for him. She studied the office products industry. Now, she was off by a factor of three. She concluded it was a \$45 billion business growing at about 15 percent a year. It turns out it was over \$100 billion, but at that point it didn’t matter much. It was really a big, growing industry. And in fact it was an industry where prices were too high, particularly for small business. And the opportunity was really extraordinary.

The fact of the matter is we are a very entrepreneurial country and the immigrants who come here, particularly the more recent immigrants from Asia and Latin America, are extremely entrepreneurial. And I think, quite frankly, that Staples and others have contributed to making it easier to work remotely in a small business. It used to be that having a printer was a big deal. Today, we’ve brought computing down to the small business and the home office. We’ve made it affordable for you to run a business on a very, very decentralized basis. And we’d like to think that we’re not just the beneficiaries of this growth in entrepreneurship, but that we have also to some extent been the cause of it.

Walt Salmon has a wonderful way of saying things. He uses very sophisticated thoughts for very simple things. And he said to me one time early on when we were still thinking about the grocery industry, “Tom, how do you think about this grocery alternative? Do you believe that you can materially out-execute Shaw’s and Stop and Shop?” I stopped for a second. I said, “Out-execute, ah, boy Walter, it would be challenging.” And he said, “Well, what if you took the modern distribution techniques and low-cost techniques that you learned in that industry and applied them to another fast-growing industry which has not been as well served by modern distribution channels?” I said, “Walter, as a matter of fact I’ve been thinking about exactly that kind of thing already. Let me show you a few pages I wrote about the office products industry.” And in effect his endorsement of that principle was another step along the way in moving towards that business plan.

Building the Business

It's a little ironic to be sitting here today saying, "Gee, we converted the office products industry to the supermarket model." Because as we sit here now some fifteen years later, we're actually spending a lot of time taking those very elements of our business apart. But let me explain. When we began, we realized that you had to find a low-cost way of distributing if you wanted to get the prices down for the small-business consumer. If a big corporation, like Harvard University, buys a lot of office supplies that we are lucky enough to sell, and we ship them full truckloads at a time, it's a pretty low credit risk. It's a fairly safe business, and it's a multimillion dollar business. They buy fairly well, and our costs are pretty low, particularly if they order on the Internet.

Now if you look at a very small business, the way to get the cost down, ideally, is to let the consumer do his or her own work. That's what a supermarket does. You roll your own cart around and you fill it up. The things we began the business with, from legal pads to file folders to pens and paper and ribbons, were pretty much entirely self-service items. The industry has evolved though since then. Today we no longer sell a Day Runner, which you could pick up off the shelf. Today we sell Palm Pilots and Handspring Visors, and we need to sell accessories and power supplies and so forth, items that are all highly pilferable, so you can't lay them out on the shelf. You also have to have people who know how to sell these things, so frankly we've gone beyond the supermarket now and are moving into the realm of a somewhat higher-service-value enterprise, particularly in parts of our stores. So that's a challenge for this millennium.

Since the beginning, though, our systems did a number of things, some of which are common to grocery stores, and some of which actually went away from the grocery store model. Grocery stores do not typically have unit control of inventory. That is to say they don't necessarily maintain the cost controls for their business and the unit controls all based on a single unit. They do perhaps control the units, but they'll do dollars based on the so-called retail accounting method. At Staples we embraced the methodology of right away having unit control of inventory. We actually knew our gross margins immediately after selling the goods: what the customer bought it for, what we sold it for, and what the margin was. We knew our on-hand on a daily basis, and more frequently if we wanted to poll stores more frequently.

So we built this pretty elaborate just-in-time system. We copied the fact that we had a warehouse in the grocery industry to buffer our stores. Our competitors said you didn't need that. And we were the pioneers, and four or five years before they did, we enhanced our cost structure by putting in central distribution. And today we've got four big mega facilities of between 500,000 and 1,000,000 square feet that in fact ship to our stores on a just-in-time basis. We also had a terrific relational database where we could, in effect, bond with our customers. In those days you needed a card to get the best prices in our stores. We forced you to do it. Today, in a more free society, we've liberated you and let you elect to take our dividends card. Today the dividends card operates more like a frequent flyer kind of program. We also have a gold level for our best customers and so forth. It's a great way of relating to our very best customers. Some say we were

revolutionary in this approach to customers. We don't say we revolutionized anything other than the office products industry, which I think is the one fact that's beyond dispute.

When we began the business, our theory was that first of all you needed to have a group of individuals who had a tremendous work ethic. Second, you needed a group of individuals who were very flexible from a time and energy perspective because this was going to be just an incredible task for the first few months. So we did not end up with married people with two kids in school. The very young or typically empty-nesters were the pools we drew from. And we sought out experienced people who had done a number of things because if you came with us you wouldn't be the Vice President of Human Resources or something like that. Myra Hart, in her case, early on had store operations, construction, office management, and maybe even real estate. That's the way it works when you're a very small business. So we needed generalists. We were lucky that we got some pretty good HBS alumni who had been in Star Market or Jewel, and whose careers had not turned out quite the way they wanted to for one reason or another, and thus they became available to us. And they worked out well for us.

People ask me, how does it feel to be the father of an industry? And I've always joked and said that I wished I had used a condom. It clearly made it much more difficult building a business when literally within two years we had twenty-five clones. And every venture capitalist who hadn't gotten into our deal went out and funded someone else. Now luckily, most of these guys fell by the wayside. But we also had some big companies. We had International Paper, Ames Department stores, Montgomery Ward. They're not the great names they once were, but in those days they were like K-Mart. All came into our humble little business. And the fact that the entrepreneurial companies who started the industry, we being the first and Office Depot being the second, fifteen years later as the industry has played out still have a leading role, really says something about America's entrepreneurial culture. The entrepreneurs won.

At the end of the day, our success was all about execution and about people. The people knew what they were doing and we kept adding more and more of them. So we would always "power build" the organization ahead of what the challenges were. And people say, "What do you do when you hit the potholes in the road?" I say, "You don't understand. My job is not to figure out what to do when we hit the potholes. My job is to get the paving machine out there three or four days in advance so that road is nice and smooth by the time our forces hit." That's what you've got to do. You've got to anticipate and power-build and build ahead. We have always done that very, very well.

Take for example our president today, Ron Sargent, an HBS graduate. We hired him in Ohio to be the district manager and VP for our Ohio stores. We entered there in 1988. Today he is president of the company. That kind of growing from within and having lots of talent before you need it, to the extent that you can afford it, is very, very important. So when I say paving ahead, it's either on the one hand anticipating the human challenges and hiring in advance of that, or it's building the systems infrastructure or the distribution infrastructure so that you can deal with the rapid growth that's ahead. For example, it's a lot harder to open stores if you are relying on the vendors, 200 of them, to ship to you in

each and every store than if you're allowing them to ship to one distribution point, a challenge in and of itself, and then you take care of the logistics of getting it to each and every store on a just-in-time basis. It makes it easier for all parties involved.

I'm not sure it's safe to say Staples ever had a near-death experience. We tended to raise money when we didn't need it, ahead of time. We did that very well. I'd say the closest we came to really worrying about the business was probably the first day we opened our doors. I think we did \$8000 that first day, and most of that was from friends and relatives. And we wondered, was this really going to work? On the second day it was even worse because the friends and relatives had largely gone by then. We were really nervous. Then slowly but steadily the word-of-mouth spread, and people would say, "You know that copy paper you used to pay \$70 for down at Bob Slate in Harvard Square? These guys are selling it for \$24. Do you believe that?" And that word-of-mouth grew, and the next thing you know our sales grew to \$10,000 a day and \$20,000 a day and we started to feel we had a winner.

We did a few ads in newspapers but we couldn't afford very many. We did a lot of direct marketing. As a matter of fact, we sent bribes out, \$10 bribes for people to go shop at the store. And in some sense, in the research sense, people could tell us what they bought with the \$10 in cash. People didn't realize how much they were spending on office products. They thought they were getting a good deal because the guy would say, "I'm giving you a 20 percent discount." He didn't tell them it was off a ridiculous list price, whereas we were selling our office products at 50 percent off. So only when the word-of-mouth spread did it really explode. I'd say that of the great direct marketers in the world, we were among the first to apply that as vigorously as we did to a retail concept.

The Internet

In terms of the information revolution, I began looking at what was going on with the Internet back in the mid-1990s. It was clear to me that at some point in time, particularly as high-speed access grew and I was certainly right that that was going to take a fair amount of time, the Internet would become a major way for people to shop. And it would be particularly relevant for goods that were easily commoditized, easy to ship, particularly to a business with pretty regular business hours. We were pretty big in the delivery business, so we'd clearly play there some day. The question was how fast to play? We had an awful lot of growth going. We had Europe going. We had the contract stationer business going. We were trying to buy a direct mail company. We were growing our retail stores like crazy. We were opening tech centers. We didn't need a lot of new growth initiatives to keep the numbers going. And the Internet seemed kind of fuzzy.

So we actually were a little slow to the Internet. Office Max launched a site. I don't think it was a great site, but they launched a site and were doing some business on the Internet. Office Depot launched a pretty nifty site back in early '99 it must have been. We meanwhile put up a site, and we were doing some nice things on it. We were getting a lot of catalogue requests on it. We were getting a lot of people clicking through to find a map to the nearest store. That was proving to be pretty gratifying. We were not yet taking

orders. And the strategy group came up to me and said we really ought to step this up and build orders into it but it will cost a couple million bucks.

We started thinking about it, and then lo and behold comes Amazon. Amazon, at least at that point in time, in the eyes of most beholders, essentially had blown away Barnes & Noble. You couldn't go to a Harvard Business School professor, irrespective of what his discipline was, without him showing you this chart of what Amazon's market value was, what Barnes and Noble's market value was, what the trends in sales of books were, and where the business was inevitably, without question, going. Everyone was talking about the first-mover effect and the network effect and how that all worked. It was enough to scare the living daylights out of you if you had a reasonable level of intelligence, and a lot of folks back here did.

We wrestled with what to do. At this point the stocks began just going bananas. And we said, "We're not sure this is really going to last. What we'll do is create a structure so that we can take advantage of the trends now and do the right thing in terms of hiring people in this Internet-crazed, stock-crazed world." We also created some separateness between the Internet and our traditional businesses, in order to isolate the large losses we would incur there. At the same time, we created a structure that we could, if we had to, reverse without a lot of outside interference.

In the meantime the structure worked. We put our single most talented executive, Jeanne Lewis, in there to build the business. She built a phenomenal Web site. Within six or nine months she had surpassed Office Depot's public site in traffic, and we believe revenues although we don't know because they don't disclose theirs. We were taking a clear leadership position in the dot-com arena as it pertains to office products for small business. I think our vision is to expand that position into selling a broader array of goods and services beyond just Staples to our target audience, and we're having some very interesting early successes doing that as well.

If you look at great business, they typically have the ability to make decisions, not have decisions made for them. And secondly, they're fairly analytical. At Staples, if we were to rate ourselves in the terrestrial world, the one thing we would probably slap ourselves on the wrist for is that we can be too analytical. We can analyze things too much. There are people here who are far more impulsive decision makers. I probably would be one of them. Jeanne Lewis would be a second. We still were pretty analytical relative to most people in the dot-com space. We didn't overpay for ad banners, for example. We analyzed exactly what they were worth and we played that way. But we moved quickly. We just made decisions on the spot. The goal here is to do the right analytics. You don't need to take a long time because you get the information back in hours or days, not in weeks and months. So your ability to absorb that information and to come up with new directions is greatly enhanced. We're lucky to have under Jeanne's leadership a team that's pretty nimble and nifty and gets that done.

Mentoring Other Entrepreneurs

Mentoring others is one of the most gratifying things in business. I've been very proud of the folks I've mentored, first and foremost, here at Staples. Ron Sargent, back in 1988 or '89, was given charge of our direct catalogue business, which was doing about \$25 or \$30 million and losing a lot of money. We gave it to Ron and moved him away from reporting to the president at the time, and had him report to me so I could in effect shepherd this business through. Occasionally I would tell him what ditches to watch out for, but he just did a great job managing that business. Todd Krasnow is another. He was our marketing executive here for years, and that's sort of my area. He and I worked together for years, and he's grown to be just a terrific marketer. I have been fortunate now in the last few years to work with Jeanne Lewis, and that's been a wonderfully gratifying experience. She is a truly talented lady, and she gets stuff done. She's very strong willed. And she's very customer focused. And we're just very, very proud of what she and her team have accomplished. There are scores of others.

Occasionally, people move on. Todd Krasnow one day decided he was very, very frustrated in his role at Staples as the company's public voice in fighting the Federal Trade Commission. For six or seven months, he was battered every day in the press. Todd had to be deposed and re-deposed and then taken apart by some of the Washington and New York media. He basically decided he didn't want to work for a big business anymore. He was about to go become CEO of another company, when I went to our Board of Directors and said, "I'm not allowed to solicit anybody from Staples, so if what I'm going to say to you doesn't work, just tell me, and that's fine." I said, "We're going to lose Todd. But if I could persuade Todd to do another idea that I have and get him to stay another year and a half to mentor a successor, could he then do something that he and I—that I think is a good idea?" They thought about it and said fine. That something turned out to be Zoots, the Cleaner Cleaner. Todd cultivated Jeanne Lewis as his successor. Jeanne did a great job with marketing and then moved to Staples.com. And now Todd is making sure he doesn't lose anybody's ties or dresses.

The idea for Zoots was mine, and like most ideas that I've had, including Staples, it was born out of my frustration as a customer. I just found going to the dry cleaner incredibly frustrating. Their hours weren't very convenient. Whenever they lost something, it was your fault, not their fault. They weren't terribly reliable. And I was thinking there's got to be a better way. And of course Todd is the entrepreneur who has really worked hard to create a better way, and it's been gratifying to help him out. He and his team have engineered new and better ways of doing dry cleaning, not that anybody in an industry could ever be perfect because I'm not sure you can, but you've got to make the promise to do it right or make the customer whole. And Todd and his team have done just that. So they're satisfying more and more customers each day, and the business is just exploding.

I'd say that in any collaboration, Todd and mine included, openness is a big factor. Todd's got to be able to say what's on his mind, including, "Tom, I'm sick of hearing this idea, I've heard it for the fourth time, and the answer is: I'm the CEO and you can't do that." He's got to be able to say that to me. And I've got to be able to say to him, "Hey Todd, I don't care whether you're the CEO or you're your investors, I feel very strongly that you need to do the following and here's why." You have to be able to speak with that kind of

candor. Not that you speak that way often, but I think you need to have that kind of candor and openness and trust or it doesn't work. And we're fortunate to have had that over a number of years.

Choosing a board is very important. If I were an entrepreneur starting a new company and creating a board, in addition to having a couple of the key money people who ideally add value and represent the investors, I would want a couple of young operating executives facing similar problems. In the case of Zoots, we have the President of Dunkin Donuts on our board, and he is a perfect fit for us. I would also like to have expertise in an area that's important to us, so with Zoots again we had a fellow HBS classmate named Ilene Lang, who's run a number of Internet companies. She founded AltaVista and she's really brought some Internet savvy to our Board. I would also want some veterans who've been around the wars a couple times. I had Leo Kahn in that regard. I guess Todd's got me. And that helps.

In the end, the biggest skill an entrepreneur brings from one venture to another is the ability to know what kind of people and what kind of team to put together, and the ability to have a very focused leadership and a clear vision about getting things done.

Summary Reflections

For me, success is having made things better. I think if you look back at how people bought office supplies before Staples showed up, you got your pens and papers at a stationery store at high prices at inconvenient hours. You had to go to an equally inconvenient machine dealer to buy whatever technology you had then. You had to go to Business Land, the late Business Land, to get your computer, and they weren't terribly good or convenient. Then you had to go to a supermarket to get your janitorial stuff and your coffee. And boy, it was a lot of work and everything was full price. Putting it all under one roof at a significant discount over what people used to pay, and now bringing all that to the Internet and delivering as well—I think we've made things better for people. Our people are very proud of having done that. And I think that's really what it's all about.