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How Ace Hardware Turned Corner Stores Into A $4.7 Billion Co-Op

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Ace CEO John Venhuizen. Photo: Jeff Sciortino For Forbes

When Jeremy Melnick’s grandfather opened his first Ace Hardware store along Chicago’s ritzy Gold Coast in 1950, there wasn’t a whole lot of competition. Wal-Mart? An Arkansas five-and-dime. Lowe’s was two stores in North Carolina. Home Depot HD +0.15% was still 29 years away from opening its first location. Amazon CEO Jeff Bezos was 14 years shy of being born.

The Melnicks — Jeremy, 43, and dad Les, 67 — own six of the 4,794 Ace Hardware stores that make up the country’s largest retail cooperative outside the grocery sector.

As they’ve expanded their family business-within-a-business into a local chain, some 20 Home Depots have cropped up along greater Chicago’s highways and strip malls in the past two decades, each 100,000 square feet (versus the Melnicks’ 8,000-square-foot corner stores). “They surround us,” Jeremy says.

Not that he’s complaining. Despite the competition, his business is good. Surprisingly good. And so is Ace Hardware’s bottom line. The Oak Brook, Ill. co-op expects a year-on-year revenue increase of 13% to about $4.7 billion and a profit boost of 35% when it releases its 2014 annual report in April, following eight consecutive quarters of record sales.

The reason for success, explains Ace CEO John Venhuizen, a charismatic 44-year-old who speaks with the fervor of a preacher, is store owners like the Melnicks: entrepreneurs with a deep knowledge of their local market, inventory fine-tuned to a neighborhood’s demographic and the sort of exacting customer service a typical big-box store with low pay and high employee turnover just can’t match.

Jeremy knows the make and model of bathroom faucets installed in every condo complex and apartment building within a short drive of all his Chicago stores –a boon in attracting fellow small business owners, like local plumbers, to Ace.

“It’s a big deal,” says Venhuizen, a 22-year company veteran. “It’s a differentiator. And I’ll tell you, it’s exceedingly hard.”

Jeremy knows his stores’ strengths. He doesn’t sell lumber. For that you can go to Home Depot or Lowe’s. He does sell what seems like every kind of lightbulb in production. When a bulb blows he knows you’d rather grab a new one from your local Ace than navigate the labyrinthine aisles of a big box or wait in the dark for an Amazon delivery. “If you want to remodel your house, you’ll go to them,” he says. “We’re making our money $20, $25 at a time.”

The company’s co-op business model means its store owners are its only shareholders. It’s the opposite of a franchise system: Thousands of entrepreneurs like the Melnicks band together to boost their collective buying power and reduce costs.

The corporate structure, with Venhuizen at the helm since 2013, exists only to do their bidding, overseeing 14 regional distribution centers that supply each store with the right mix of $800 Weber grills and $15 hammers.

When an Ace store opens (or an existing hardware outlet converts to Ace), the owner buys $5,000 in shares. He or she can purchase any of the 80,000-odd products from the co-op’s warehouses, make use of the well-known red-and-white logo and branding (“The helpful place,” its motto promises) and receive dividends based on purchases rather than equity.

Each store kicks in for activities that benefit the whole co-op, like advertising and marketing (Ace’s annual ad budget is $100 million).

In the past 18 months Ace has seen some 144 stores jump ship from competitors, including a handful from its two fellow hardware co-ops, True Value and Do It Best. During that time just 49 Ace stores have left the fold.

“In order to increase your market share, you have to go out and steal stores from someone else,” says Jim Robisch, senior partner in retail at the Farnsworth Group, a home improvement industry consultancy.

And if a store is consistently underperforming? “Ace is really strict at controlling the integrity of their brand. They have a crew of people who’ll go round and tear those Ace signs down whether you like it or not.” (A spokesperson says stores that fall short of standards must remove Ace logos, but they still have access to Ace’s supply chain.)

The company was born in 1924 when four Chicago-area entrepreneurs decided they could get better deals on inventory by joining forces. Ace opened its first warehouse just prior to the 1929 crash and subsequent economic devastation, its founders capitalizing on a need for hardware and tools as homeowners were forced to do their own patching up and repairing.

The company briefly flirted with converting from a retailer-owned co-op to a for-profit corporation during the most recent recession in 2007.

"There would have been no change in shareholder ownership, only structure," says Venhuizen. "With the relatively new U.S. dividend tax structure, there is a less compelling capital argument to make such a conversion now, so we have no existing plans to do so."

Next up, Ace is tackling same-day delivery, one of the hottest trends in retail. Tests in 33 stores across six states started on Jan. 26. It's a pretty obvious move, says Venhuizen, since 70% of U.S. households are within a 15-minute drive of an Ace store.

"I don't know if you can deliver a grill with a drone, but our trucks'll get it there," he says with a grin. Besides, 60% of Ace's stores already provide delivery to customers, albeit in a haphazard way–more like a favor to a friend who doesn't have a car than part of a business model. Jeremy Melnick has delivered plungers. He's screwed in lightbulbs.

"They do this already," says Venhuizen. "Doesn't everybody?"

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