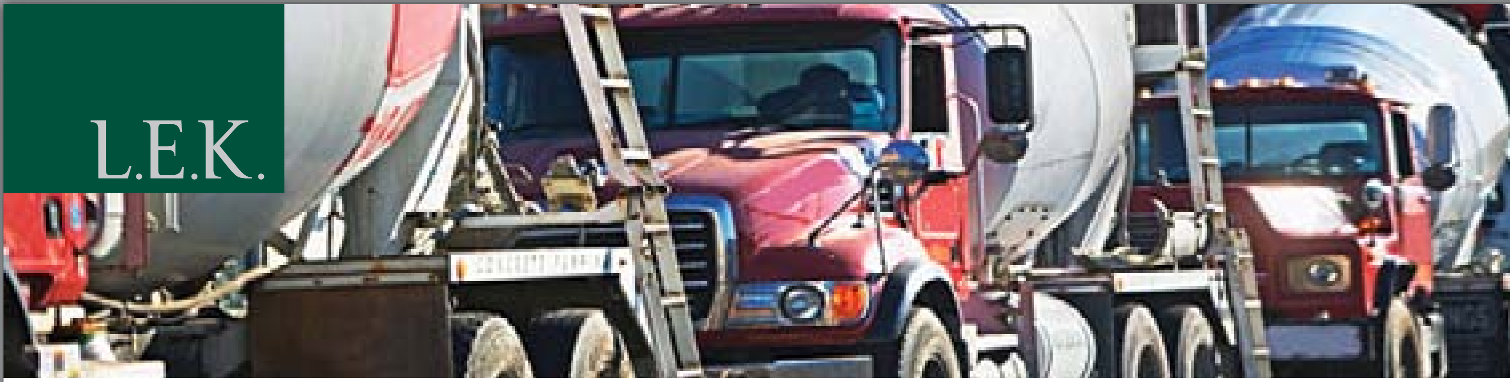

L.E.K.

EXECUTIVE INSIGHTS

VOLUME XIII, ISSUE 21

Pinpointing Channel Opportunities in the Building Products Industry

The recent market cycle has resulted in channel shifts that create opportunities and challenges for original equipment manufacturers (OEMs) and distributors in the building products markets. L.E.K. Consulting's research across multiple residential and commercial product categories indicates that both contractors and homeowners have changed *how* they conduct product research and *where* they make their buying decisions. Building product manufacturers and channel participants must evaluate how contractor and homeowner channel habits have evolved to position themselves successfully relative to the market evolution.

The Market Cycle's Effect on Contractor Brand and Channel Decisions

In 2011, L.E.K. surveyed more than 500 U.S. contractors across 15 product categories (e.g., roofing, etc.) to understand their perspectives on business health and what they have done with respect to product and channel selection between 2006-2010 to remain competitive. Our research identified a number of key insights:

1. Contractors have responded to price pressure by changing channels, not brands: Nearly 55% of contractors surveyed indicate that they changed channels to purchase cheaper SKUs of the *same* brand.

2. Contractors want greater product breadth and convenience from the distribution channel: More than 40% of contractors in select trade categories have pursued a broader range of services (led by drywall, masonry, siding and tile contractors). As a result, contractors are emphasizing convenience factors such as on-hand stock and delivery speed when deciding where to purchase building products.

3. Contractors have shifted purchases away from one- and two-step distribution toward the big box channel, but this shift is temporary: Contractors have increasingly gravitated to big box retailers, especially in roofing, light appliances, kitchen and bath, and electrical. However, as the residential and commercial markets improve, L.E.K.'s analysis indicates that contractors will return to one- and two-step specialty channels (specialty chains and independents). One-steppers, in particular, are expected to recoup most of their recent share loss in areas such as roofing, carpentry, paint, siding, drywall, windows and doors.

4. Homeowners are more engaged in brand purchase decisions: More than 30% of contractors report that homeowners' influence on product purchasing decisions has grown since 2006. Homeowners are increasingly conducting self-directed research on products (e.g., kitchen cabinets, faucets, etc.), and then making purchases via alternative channels (e.g., Internet, wholesalers, etc.).

Pinpointing Channel Opportunities in the Building Products Industry was written by **Thilo Henkes**, a Vice President at L.E.K. Consulting. Please contact us at industrial@lek.com for additional information.

(Please see our *Executive Insights* volume XIII, issue 6, titled *Changing Contractor Behaviors Have Impact Across the Value Chain*, for additional research results.)

Implications for Building Products Brands

The current market cycle is an opportune time for building products OEMs to revisit their channel strategies and identify opportunities to grow business and potentially take share. L.E.K. believes that there are a number of areas that OEMs should analyze to find these opportunities:

1. Take advantage of contractor brand loyalty: Contractors have remained brand loyal through the cycle and indicate they will likely return to their preferred SKUs and channels as the market rebounds. So trying to pick up share by ceding price is unlikely to create value through the cycle or in the long term.

2. Identify and target high-value customer segments: A defined view of customer segments will help OEMs identify opportunities with the greatest sales potential. OEMs can prioritize customer segments and develop specific programs for these select audiences (see the case study sidebar). An important element of this segmentation is to understand where contractors are shopping today and how their purchasing patterns may have changed. Preferred channels should help brands reach specific audiences and also provide advantages to OEMs in non-price ways in exchange for a share-of-wallet trade within the channel (e.g., advantaged supply lead times, breadth/depth of inventory, flexible accounts receivable terms and bundling across categories).

3. Rebalance your distribution footprint: Brands should rethink how to reach specific segments (contractors and homeowners) as they channel shop. This makes channel ubiquity pivotal for a brand's success, especially for mature products with commodity-like properties. Increasing reach, however, may require OEMs to calibrate their sales and product strategies to serve a broader array of contractors (and homeowners in some cases) with different SKUs across channels to avoid channel conflict. Brands such as Certainteed, Moen and Owens Corning have managed to sell across both big box and specialty channels in specific product areas (e.g., fiber cement siding, faucets, roofing shingles, etc.) by varying SKUs and brand names in those channels.

4. Reinvigorate investment in the specialty channel contractor education and affinity programs: OEMs, particularly those that are not brand or category leaders, and who rely on the specialty channel to help educate contractors, have had an especially tough time because the specialty channel's response to declining share has been to focus less on education and more on preventing sales declines. L.E.K.'s research across multiple product categories indicates that the specialty channel became complacent about educating customers about products and brands because they feared customers would then leave and price shop. OEMs need to invest in channel education and incentive programs to drive product placement and share as one- and two-step distribution channels regain share from big box stores.

5. Invest in education downstream: As homeowners conduct more self-directed research and insert themselves into the brand decision-making process, digital channels will continue to grow in importance for OEMs. Brand web sites that include "how-to" videos or other useful information beyond straight sales content are more likely to differentiate themselves from the competition and foster brand loyalty. (Please see our *Executive Insights* volume XIII, issue 13, titled *Using Social Media Tools to Influence Homeowners' Building Products Choices*, for additional background.)

Drafting a Blueprint for Channel Growth Opportunities

L.E.K. sees moderate growth in residential activity next year, and many believe that the broader market will slowly recover in the foreseeable future. Now is the time for OEMs and distributors to revisit their channel strategies and position themselves to take share. There are a number of steps to increase success, including:

- Leverage your brand loyalty. Contractor willingness to channel shop for preferred brands illustrates that OEMs may have more pricing power in today's market than suspected.

- Reassess product tiers and pricing to identify opportunities to leverage brands/products across channels without creating confusion or cannibalization.

- Understand how channel decisions will be made by contractors and homeowners going forward, both within and outside of the channel, and target customer segments that resonate with your brand.

- Augment marketing strategies to address the increase in decision-making outside of the traditional channel.

OEMs have a significant opportunity to increase share as the economy improves. This requires executives to expand the breadth of their channel programs to maintain a strong presence in front of today's contractors and homeowners who are actively looking across channels for their favored brands.

A new level of depth is also required to address the emerging voice of the homeowner and create a viable presence in other market access points, including digital channels. But increases in some areas will require trade-offs in others. This means that increasing your reach will require OEMs to refocus on targeting the market segments with the highest growth potential.

High-End Residential Plumbing Brand Retools Its Product Line and Channel Strategy

A luxury plumbing brand that distributes its products through the specialty channel was losing share and turned to L.E.K. to identify growth opportunities. L.E.K. surveyed contractors and homeowners who had recently made purchases in the plumbing product category to understand the most important product selection attributes (e.g., trendy/stylish, unique design, superior quality, reliability), and we determined that certain attributes were points of differentiation for decision-makers. Some criteria not only mattered in terms of their impact on the decision process, but they were also important to sizeable segments of the population.

Although our client's brand was not sufficiently differentiated, we determined that some of the key selection criteria that our client's brand could pursue were not well claimed by competitors. This analysis identified a number of attractive opportunities for focusing our client's product portfolio and clarifying its value proposition.

In parallel, L.E.K. examined which channels contractors and homeowners were using to purchase luxury plumbing products and found that the specialty channel was losing share to alternate channels such as the Internet. We also determined that specialty channel sales consultants significantly overestimated the mix of decision makers who knew what brand they wanted. Fearful that they would lose customers, these sales consultants pushed the major brand in the segment rather than attempting to educate customers about other options, even if those options offered similar feature sets and offered the channel more favorable economics.

Using this insight, we determined how to hone our client's product offerings and value proposition. Specifically, L.E.K. developed a brand repositioning strategy that targeted specific customer segments and expanded the company into alternate channels. L.E.K. also developed a new channel education program to give sales consultants in the specialty channel specific tools to help differentiate our client's brand with confidence.

Based on our recommendations, our client has improved its sales and profitability, and has gained a significantly stronger competitive position in the product category.

L.E.K. Consulting is a global management consulting firm that uses deep industry expertise and analytical rigor to help clients solve their most critical business problems. Founded more than 25 years ago, L.E.K. employs more than 900 professionals in 20 offices across Europe, the Americas and Asia-Pacific. L.E.K. advises and supports global companies that are leaders in their industries – including the largest private and public sector organizations, private equity firms and emerging entrepreneurial businesses. L.E.K. helps business leaders consistently make better decisions, deliver improved business performance and create greater shareholder returns.

For further information contact:

Boston
28 State Street
16th Floor
Boston, MA 02109
Telephone: 617.951.9500
Facsimile: 617.951.9392

Chicago
One North Wacker Drive
39th Floor
Chicago, IL 60606
Telephone: 312.913.6400
Facsimile: 312.782.4583

Los Angeles
1100 Glendon Avenue
21st Floor
Los Angeles, CA 90024
Telephone: 310.209.9800
Facsimile: 310.209.9125

New York
650 Fifth Avenue
25th Floor
New York, NY 10019
Telephone: 212.582.2499
Facsimile: 212.582.8505

San Francisco
100 Pine Street
Suite 2000
San Francisco, CA 94111
Telephone: 415.676.5500
Facsimile: 415.627.9071

International Offices:

Auckland
Bangkok
Beijing
London
Melbourne
Milan
Mumbai
Munich
New Delhi
Paris
Shanghai
Singapore
Sydney
Tokyo
Wroclaw