

## L.E.K. Contractor Behavior Survey: Building Momentum

After one of the most difficult downturns in recent memory, L.E.K.'s 2013 contractor behavior survey revealed rising contractor job revenues, reduced bids lost on price and a number of other positive factors, confirming that the residential construction recovery was, in fact, for real. The momentum carried through into 2014, according to L.E.K.'s most recent survey, as contractors once again reported healthier margins and sustained job growth, showed ongoing resolve with respect to pricing new projects, and also continued to emphasize a preference for one-stepper, broadline or specialty dealers over big-box stores and home improvement centers. While not nearly as tech savvy as other industries, a growing number of contractors continue to use web and mobile resources for the purpose of comparison pricing, checking on availability of building materials and other services.

As in past years, L.E.K. surveyed more than 500 residential contractors representing the major geographic regions of the United States. To help gain greater insight, L.E.K. also assessed the state of the commercial contracting segment through a first-time survey with more than 250 non-residential contractors, highlighting similarities in contractor sentiment as well as areas where the two groups diverge.

### Residential Building Segment

The beginning of 2015 finds residential contractor optimism once again on the rise with survey respondents affirming

year-over-year improvement in both project quantity and revenue growth (see Figure 1). Having finally broken into positive territory during 2012-13, residential contractor revenue per job growth continued to trend upward last year as contractors reported the largest per-job revenue gain since the start of the recession (2014 also saw the greatest year-over-year increase in total jobs since L.E.K. began its industry polling in 2010). While peak-season hiring was flat to slightly down during the past year, the ratio of new building jobs to total projects continued to grow during 2014. Furthermore, the anticipated surge in housing demand bodes well for the industry going forward, with the average number of peak-season employees expected to surpass pre-crisis levels by 2017.

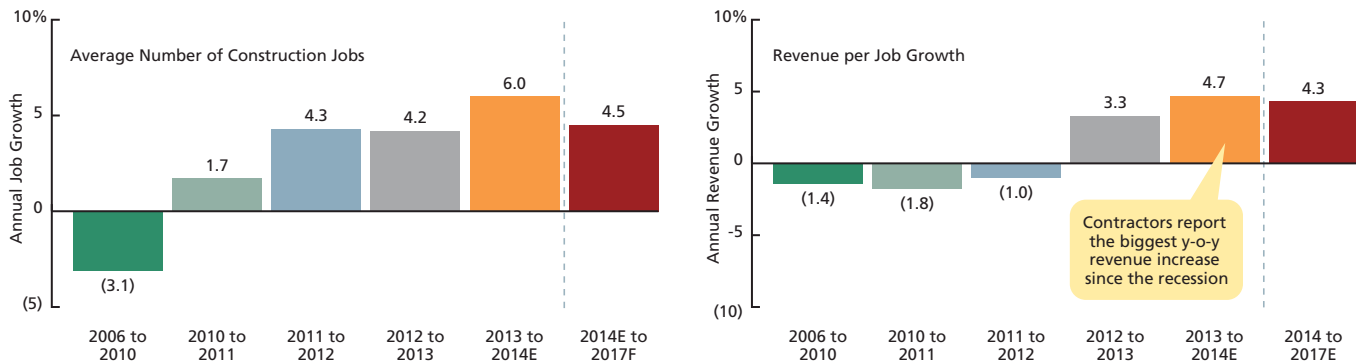
Job pricing and product-purchasing behavior also reflect an increasingly confident contractor base. Though not nearly as pronounced a year-over-year drop as the 2012-13 period, the number of bids lost due to price nonetheless remained favorably low at 21% during 2014, on par with 2008 levels, and a 13% drop over the last three years. Finding contractors willing to work on the cheap became even more difficult during 2014; only 17% of those polled reported accepting lower-margin jobs, versus 26% during the previous year. Additionally, there was a near 50% drop (20% in 2014 vs. 39% in 2013) in the number of residential contractors that indicated they were performing extra services on jobs in order to combat price pressures.

---

*L.E.K. Contractor Behavior Survey: Building Momentum* was written by **Robert Rourke**, a managing director in L.E.K. Consulting's Chicago office and **Thilo Henkes** and **Darren Perry**, managing directors in L.E.K. Consulting's Boston office. For more information, contact [industrials@lek.com](mailto:industrials@lek.com).

---

**Figure 1**  
Average Number of Construction Jobs and Revenue per Job Growth (2006-17F)



## Remaining Loyal

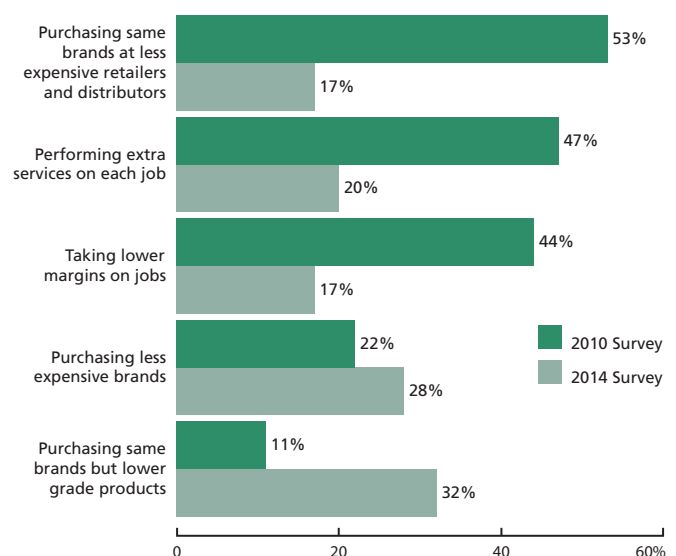
Another bullish indicator is the ongoing trend toward dealer and brand loyalty in the face of pricing pressure. During 2014, respondents chose to keep the lion's share of their business confined to trusted channel partners, rather than bargain hunt across competing dealer or distribution channels. In fact, the most recent survey found that a mere 17% of residential contractors were willing to shop for similar brands at less expensive retailers and/or distributors, as compared to 45% in 2013 and 53% in 2010 (see Figure 2). The same holds true for building-product brand preferences: instead of seeking cheaper alternatives, the survey finds contractors sticking with their favored brands but using lower-grade versions from the same manufacturer across a number of different product categories when forced to price shop.

Which suppliers are benefiting the most in the current climate? As in past years, one-steppers and specialty dealers continue to rank highly, securing almost half of all residential contractor product purchases. In contrast to the wide-ranging but limited inventories of competing home centers, these dealers offer a more focused line of products with deeper selection, in addition to stronger pro-level services. Contractors' willingness to sustain a price increase at one-stepper/broadline and two-steppers underscores the ongoing commitment to these channels (see Figure 3). Accordingly, one-stepper/broadline and, to a lesser extent, two-stepper channels are expected to build on current levels of contractor

support, particularly as the housing market continues its expansion over the next several years.

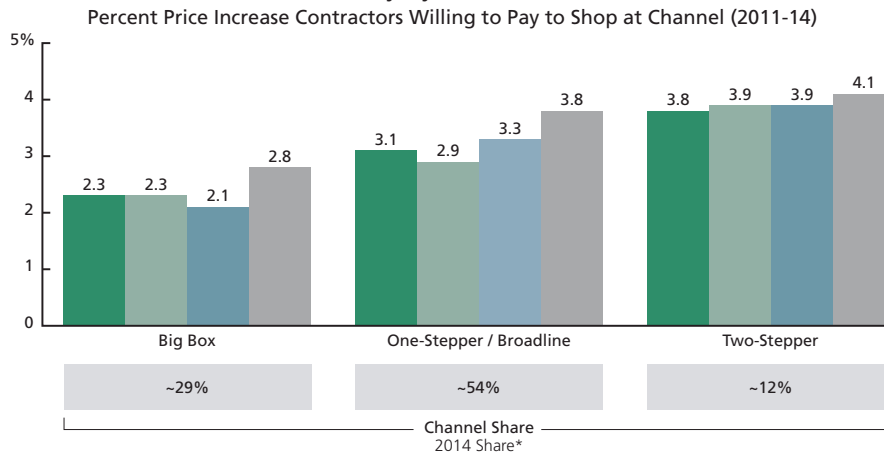
With elements like brand loyalty and product availability trumping cost, one might expect to see the big-box segment gradually falling out of favor. Indeed, contractors who frequented retailers like Lowe's and The Home Depot during 2014 did so primarily on the basis of proximity to job site (particularly for making "fill-in" purchases). With the number of new projects on the rise, contractors are more likely to stay

**Figure 2**  
Contractor Response to Price Pressure  
Percent of Contractors Rating 6 or 7



Source: L.E.K. Contractor Behavior Survey (2014-15)

**Figure 3**  
**Loyalty to Channel**



Note: \*Remaining share is categorized as online or other  
Source: L.E.K. Contractor Behavior Survey (2014-15)

well stocked in order to avoid work disruptions, theoretically reducing the number of big-box visits.

Despite this, contractor purchasing at big-box stores is expected to remain at or just slightly below current levels over the near term. Convenience remains this channel's trump card – even with healthier levels of working capital, builders continue to rely on big-box ease of access for those “fill-in” purchases. And to a lesser extent, efforts to broaden the contractor customer base through the addition of “pro brands” and special “pro service” offerings such as lines of credit, bulk pricing, mobile apps and other promotions appear to be paying off, with a slightly higher number of contractors taking advantage of such perks during 2014.

Still, the survey also reveals some cracks in the foundation: convenience notwithstanding, big box continues to trail one-steppers and other channels in purchase criteria such as product selection, expertise, delivery services and credit handling, according to respondents.

## Getting Connected

The construction business has been slow to embrace the digital revolution. Though online sales have doubled since 2006, they account for just a fraction (3.5%) of all residential contractor transactions to date (see Figure 4). Even so, contractors continue to adopt new tools with the goal of

streamlining operations (such as using order/inventory management solutions for keeping tabs on supplies), as well as meeting the needs of an increasingly informed client base. Product research remained the dominant web activity among residential contractors last year, with the majority not only using manufacturer websites for information, but also frequenting discussion boards and other user-oriented venues. The latest survey also revealed a year-over-year uptick in online price shopping (63% vs. 55%

in 2013 report having made at least one purchase online), as well as product purchasing (54% vs. 44%).

Nine out of 10 survey respondents currently own a mobile device and most reported using it for basic business purposes such as checking email, price shopping and project scheduling. Contractors are also increasingly using more sophisticated solutions such as visualization apps, which allow customers to view photos of siding, roofing, floor coverings or other material superimposed over their existing structure.

In fact, the abundance of online information has allowed homeowners to have greater input not only around more finished products such as flooring and tile, but even basic materials like insulation and drywall. Thus, while contractors' expertise still drives many decisions, their influence has ebbed somewhat with the increase in homeowner involvement.

## Commercial Building Segment

The economic upswing has led to a resurgence in commercial construction as well, including projects in retail, public works, lodging, healthcare, education and manufacturing. Though commercial construction is expected to slightly lag residential growth over the near term, year-over-year increases in job quantity and revenue were just as robust during 2014, at 6.5% and 4.6% respectively. These figures are supported by data from the U.S. Census Bureau, which saw commercial

construction spending in 2014 reach \$627 billion, roughly 6% higher than the year-ago period.

Cost pressure remains a bit more pronounced on the commercial side. Commercial contractors reported 30% of jobs lost due to price in 2014 (compared to 21% for residential contractors) and believe bidding competitiveness will hold steady at current levels for the next several years. Despite this, commercial contractors remain steadfast in their loyalty to trusted brands, and — like their residential counterparts — would rather use lower-grade products from a preferred manufacturer than channel-shop in response to cost pressures.

## Purchasing Divergence

Some differences emerge when comparing residential and commercial purchasing behavior, however. Continuing a longstanding trend, few commercial contractors (12%) are likely to be found browsing for bargains at the local big-box outlet and instead, nearly two-thirds favor the product depth, favorable credit terms and other pro-oriented services offered through the dealer channel. Going forward, the commercial segment is also likely to see an incremental rise in direct-to-manufacturer product purchasing as contractors look to maximize cost efficiencies and require more support in product selection and specification.

As has been the case on the residential side, commercial contractors cite durability, price and product availability as key criteria when making product purchases, while more than half view customer support as essential to the buying experience (eighth on the list, compared to 12th for residential contractors).

Slightly less than half of commercial contractors prioritize energy efficiency, a 9% bump over the previous year. While many continue to incorporate green materials and strategies, roughly half of commercial contractors polled would not be willing to pay a price premium of greater than 5% for green

products, suggesting that opportunities to increase prices on green inventory may be limited, particularly given currently low energy prices.

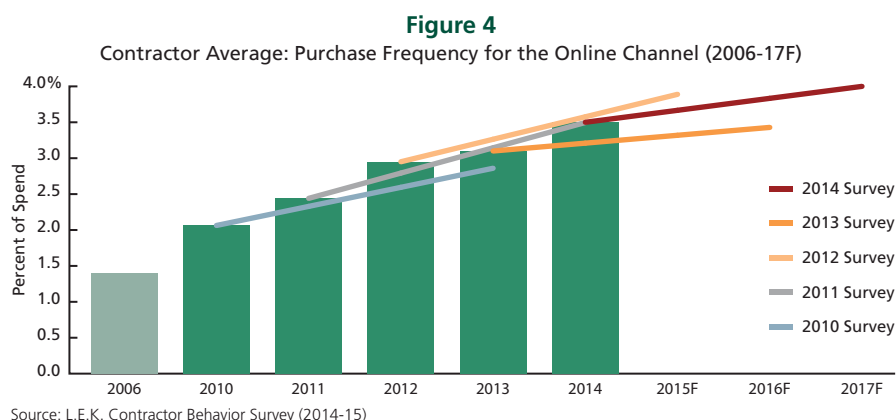
For the most part, commercial contractor internet activity has been on par with the residential segment, notably in areas such as price shopping, information gathering and product feedback. Web sales as a whole have remained relatively muted (around 2% compared to 3.5% for residential contractors), with fewer commercial contractors purchasing shippable building products such as plumbing fixtures, tile and insulation than their residential counterparts. With participation on the rise, however, web activity is likely to expand, particularly as online offerings mature and experience grows.

## What It Means for the Branded Building Products Segment

L.E.K.'s latest construction industry analysis finds increasing optimism as contractors continue to benefit from the ongoing residential and commercial construction recovery.

Strengthened by the general favorable contractor outlook, those in the building products trade can leverage these positive trends to invest in growth strategies to accelerate share gains. While there is not a single recipe for growth strategy, the findings from our contractor behavior survey reveal a few potential priorities that should be useful.

- **Keep the focus on service and selection.** Contractors once again showed their willingness to remain loyal not



only to their favored brands but also preferred dealers during 2014 (with an even greater number steering clear of high-volume home centers offering the same product at a reduced price than in the 2013). At the same time, contractors are not opposed to switching channels in order to maintain a satisfactory level of service and product quality and availability. In the quest to win shelf space, price reductions aren't nearly as important as maintaining depth of product selection, availability, as well as a multi-channel presence.

- **Enhance web capabilities.** While other tech and consumer sectors continue to adapt to today's digital world, we believe that the overwhelming majority of the internet's value will be captured by traditional industries that are only now beginning to play catch up. Accordingly, internet and mobile technology will become increasingly important to the contracting segment in the years to come. As homeowners continue to increase self-directed research, manufacturers

must respond by ensuring their websites are clutter-free and easy to navigate, optimized for search engines, and offer information like expert blogs and product-demonstration videos. Companies should also be cognizant of the ever-expanding handheld trend by incorporating mobile-enabled website content, as well as utilizing social media to reach the growing mobile customer base.

- **Provide valuable new solutions.** Manufacturers and distributors will also find it increasingly advantageous to provide marketing and client-facing tools in order to stay competitive and add more value. Accordingly, manufacturers have begun offering building information modeling (BIM) apps and other visualization tools that allow builders to virtually sample different types of materials, calculate room dimensions and locate product specifications using their handheld devices. Other opportunities include providing solutions for accessing building plans, improving productivity and mapping out new projects.

## INSIGHTS@WORK®

**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 30 years ago, L.E.K. employs more than 1,000 professionals in 21 offices across the Americas, Asia-Pacific and Europe. 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**

75 State Street  
19th 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  
19th Floor  
Los Angeles, CA 90024  
Telephone: 310.209.9800  
Facsimile: 310.209.9125

#### **New York**

1133 Sixth Avenue  
29th Floor  
New York, NY 10036  
Telephone: 646.652.1900  
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:**

*Beijing  
Chennai  
London  
Melbourne  
Milan  
Mumbai  
Munich  
New Delhi  
Paris  
São Paulo  
Seoul  
Shanghai  
Singapore  
Sydney  
Tokyo  
Wroclaw*

L.E.K. Consulting is a registered trademark of L.E.K. Consulting LLC. All other products and brands mentioned in this document are properties of their respective owners.

© 2015 L.E.K. Consulting LLC