

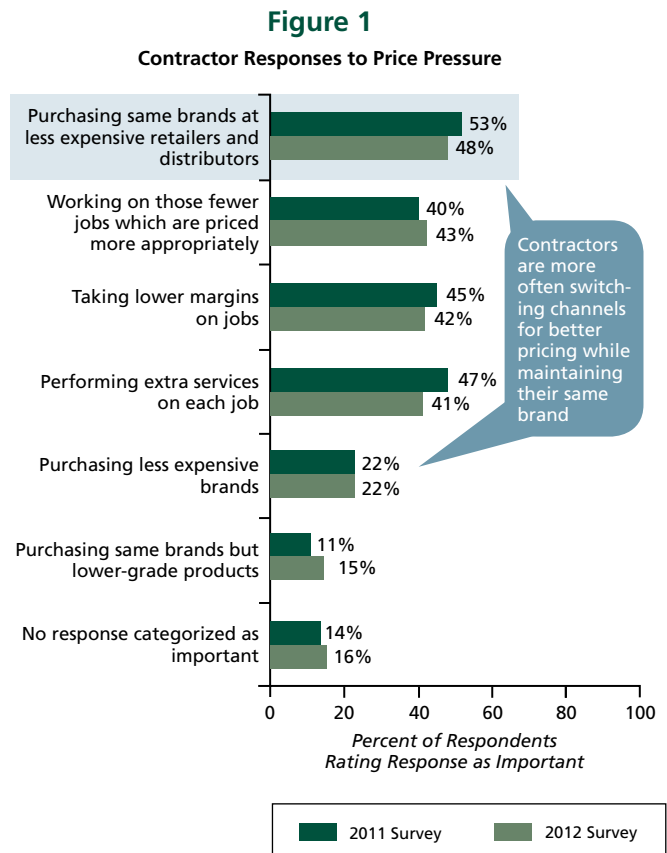


Building for the Future: Contractors Reveal New Opportunities for Product Manufacturers

Optimism is returning to contractors for the first time since the recession. Residential contractors project a seven percent increase in revenue per job within the next three years, which is a sharp contrast to just last year when they were still experiencing year-over-year declines. Contractors are cautiously looking toward the future but are changing how and where they'll shop.

To better understand contractor purchasing priorities and preferences, L.E.K. Consulting surveyed more than 500 building and construction contractors across the United States for its second annual Contractor Behavior Survey. All contractors surveyed had at least five years of experience, worked at a company with at least three seasonal employees and either had responsibility or input on product purchasing decisions.

Our research findings show that contractors continue to have strong loyalty to their trusted products and frequently shop across channels for the best prices. Next to product cost, the importance of energy efficiency and sustainability vary significantly by residential and commercial contractors for product selection criteria. And while the big boxes are using low prices to generate sales, contractors plan to return to the pro channel for value-added services as the economy improves. These market changes enable building products manufacturers and suppliers to increase revenues by reaching key segments with a clearly defined set of products sold through specific



Source: L.E.K.'s Contractor Behavior Survey

channels. Also, the findings highlight the importance of understanding how to capitalize on social media's growing influence on contractor purchasing decisions.

Building for the Future: Contractors Reveal New Opportunities for Product Manufacturers was written by Chris Kenney, Vice President and Head of L.E.K. Consulting's North American Basic Industries Practice; and Robert Rourke and Lucas Pain, both Vice Presidents at L.E.K. Consulting. Please contact us at industrial@lek.com for additional survey findings or related information.

Continued Strong Brand Ties

To address continued economic pressures, contractors continue to be more than twice as likely to channel shop for the best price on trusted, high-quality products rather than trade down and purchase less expensive alternatives (see Figure 1).

But this affinity only applies to individual products as contractors are more than three times as likely to seek out specific quality products before they will purchase lower-grade (and cheaper) alternatives in the same product line or brand.

Low Loyalty to the Big Box

Contractors told L.E.K. that the percentage of bids lost due to cost have doubled during the past four years. They've responded to these market pressures by turning to the big boxes for more competitive pricing than the pro channels at the expense of other benefits such as knowledgeable staff. This shift appears temporary, however, as contractors have very little loyalty to these stores. To illustrate, loyalty – as measured by the price premium contractors are willing to pay to shop at their preferred channel – is the lowest for the big box (see Figure 2).

But contractors are willing to increase their spend in the pro channels, which have established credibility providing these additional services. As the market recovers, one- and two-steppers (specialty chains and specialty independents, respectively), should be able to win back share based on their historical strengths of product breadth, depth and service. Notably, perceived loyalty to the two-steppers has increased the most since last year's survey.

Product and Channel Strategies

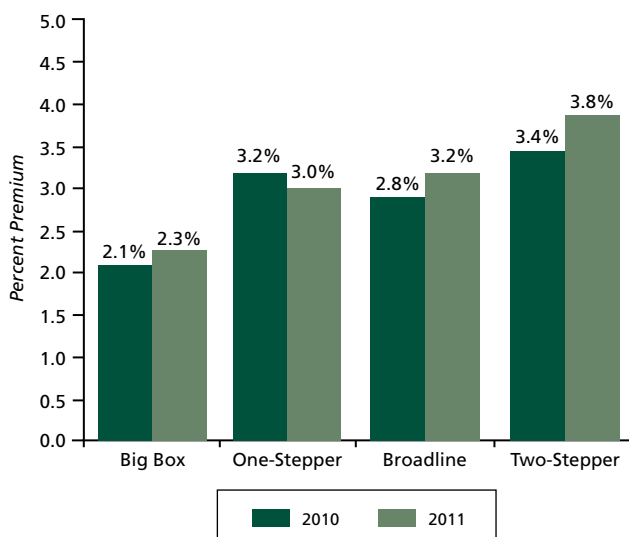
The product management implications for many building products companies are clear, and L.E.K. has developed three recommendations that OEMs should consider as they work to increase sales:

1. Refocus on the Pro Channel: OEMs traditionally surrender significant profit margins in exchange for the large sales volumes generated via the big boxes. Companies that remain overly committed to this channel as the economy recovers may face challenges trying to grow revenues and differentiate themselves in price-driven big boxes. To extract sufficient value from their intellectual property, OEMs should strongly consider selling new and premium products through pro channels where profits are traditionally higher and the differentiation is sustainable. For this strategy to be successful, however, OEMs must have clear pricing strategies among channels and establish programs to support their distribution partners.

2. Address Market Needs During Product Innovation: OEMs need to clearly understand the product requirements and pricing thresholds of their primary customer segments. For example, residential contractors are willing to pay a premium for energy efficiency, which is the second most important product purchasing criterion for them behind price. Residential contractors, however, are generally unwilling to pay any premium for sustainable products. By contrast, commercial contractor purchasing decisions are equally influenced by both energy efficiency and sustainability.

Figure 2

**Loyalty to Channel – Percent Price Premium
Contractors are Willing to Pay to Shop at a Channel (2011)**



Source: L.E.K.'s Contractor Behavior Survey

3. Leverage Social Media: A key takeaway is the growing importance of social media. Manufacturers need to develop the appropriate content strategy in response. Thirty percent of contractors say that they are using social media more today than one year ago, and 35% expect to be more active on social media during the next year. Of the contractors who use social media, more than one-third use it to follow OEMs and learn about products, get pricing and other information.

Contractors also expect the Internet to play a greater role professionally, with 48% expecting to increase their online research for price comparisons and 40% expecting to conduct more purchasing online during the next three years. Both the Internet and social media will continue to play a greater role in educating contractors and homeowners about product attributes and related information that can be central to influencing purchasing decisions.

Growth Opportunities

As the building and construction market in America slowly begins to expand after a long period of decline, contractors will have more flexibility to return to their preferred purchasing habits. However, the rate at which channel shifts occur, the opportunity for product/channel segmentation, the energy and sustainability trends and the mega-trend of social media clearly indicate the “old rules” of manufacturing and supply no longer apply. L.E.K. believes that the winners in the industry five years from now will be largely defined by the actions and strategies that are pursued now – in advance of the full recovery.

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 nearly 30 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.

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