EXECUTIVE INSIGHTS VOLUME XIV, ISSUE 2

Residential Building Contractors Shift Their Buying Behaviour as Slowdown Bites

As the slowdown bites in major European residential building markets, the combination of lower revenues, new energy efficiency regulations and an increase in technology use has had a significant impact throughout the residential construction value chain.

Contractors are the main decision-makers for building materials in the residential market and gaining insight into the factors that drive their behaviour is crucial for manufacturers and merchants.

In the autumn of 2011, L.E.K. Consulting conducted a survey of residential building contractors across the UK, France and Germany. A total of 306 contractors responded, of which 99 were in Germany, 97 in France and 110 in the UK. All respondents had at least five years' experience and were responsible for, or directly involved in, the purchasing decisions of their company.

Following the Slowdown in Residential Building Markets, Price Competition has Intensified Significantly

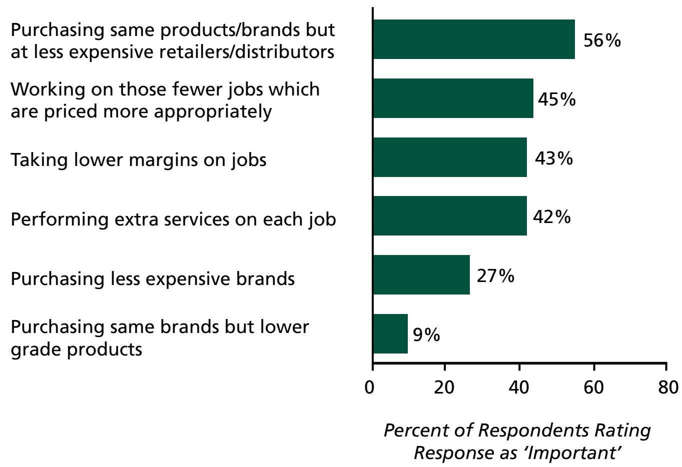
The scale of the downturn in European residential building markets differed between the countries surveyed. While the UK faced a significant decline in the new build segment, with a 40% drop in housing starts between 2007 and 2008 (when the recession officially began in the UK), the German and French markets proved more resilient, facing a 6% and 22% drop in housing starts respectively over the same period. Across the countries surveyed, there were fewer structural projects over this period, a factor which was offset by a strong uptick in refurbishment work such as insulating, plumbing and tiling. Residential renovation and maintenance markets did not suffer as much as housing starts, facing a decrease of 1% (Germany), 2% (France) and 6% (UK) in 2009.

Despite signs of recovery in 2010, especially in the UK where the recession was tougher, respondents claimed that price pressure has intensified so much that bids lost due to price competition increased by 50% between 2007 and 2011. As a response to this, contractors have become more price sensitive in their purchasing decisions and have sought to expand their service offering, especially if their focus is on technical services such as HVAC or plumbing.

Nevertheless, European contractors remain optimistic about the residential market and even more so about their own

Figure 1

Contractor Response to Price Pressure



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businesses. They forecast a 6% price increase from 2011-2014, a 4.7% growth in the number of projects per annum and significant growth in employee numbers.

Changing Purchasing Channel is the Main Response to Price Pressure

Under increasing price pressure, contractors' principal response has been to change their purchasing behaviour as a means of reducing their cost base. Whilst many respondents decided to purchase less expensive brands (27%), most (56%) switched to less expensive suppliers, staying loyal to their usual brands and range of products (see Figure 1). Where contractors preferred to stay loyal to suppliers, specialist and independent merchants were able to achieve a higher price premium than national merchants and sheds.

The role and influence of contractors in brand purchase decisions varies significantly by product (e.g., strong in drywall, weaker for tiles). Contractors feel that their role, and that of the homeowner, in brand choice is strengthening while that of the merchant is declining.

The effect of price pressure on supplier choice is most evident in the UK, where contractors have seen the highest rise in bids lost due to price pressure (an increase from 23% in 2006 to 36% in 2010/11). Consequently, contractors have switched distribution channel from national chains to independent merchants and are likely to continue to pursue this trend in the coming years (see Figure 2).

Use of the Internet as a Distribution Channel Will Expand

The internet is already used extensively by European contractors to identify and select products, with two thirds gathering information on product specifications online. They also expect a large increase in internet use as a potential distribution channel.

All contractors are expecting the internet to become an important channel to purchase products online, with German contractors and technical services providers (HVAC, electrical, etc) being most advanced in this area (see Figure 3).

Figure 2

European Contractor Purchase Frequency by Channel (2007-2014F)

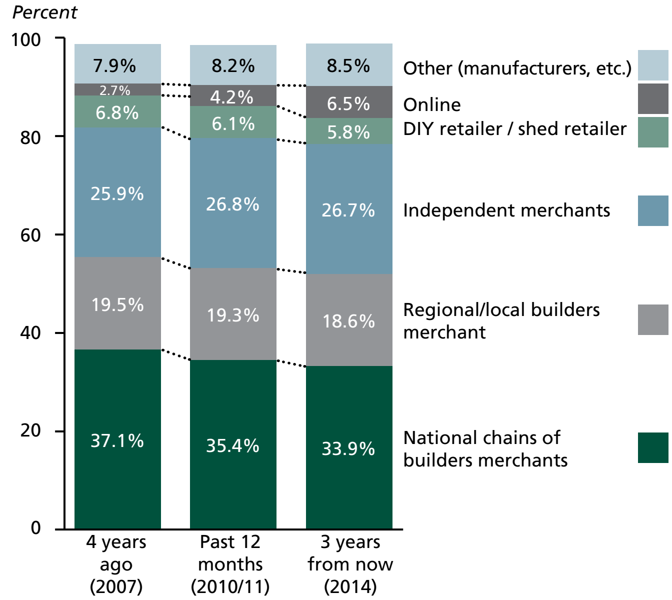
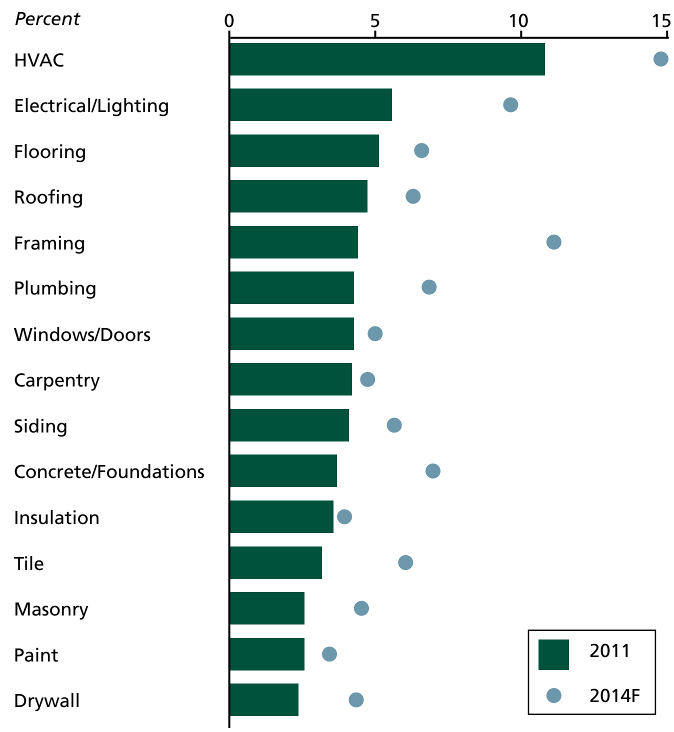


Figure 3

Contractor Online Channel Share by Job Type (2011,2014F)



Despite Market Price Pressure, Contractors Remain Willing to Use Energy Efficient Products

The survey highlights that, after price and durability of products, energy efficiency comes as the third criterion in the purchasing decision.

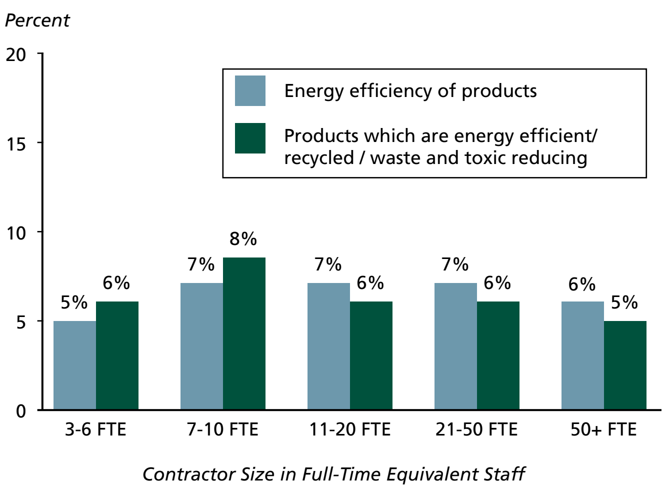
Moreover, the importance of a product's energy efficiency and sustainability (i.e. efficient water usage, toxins and waste reduction, recyclability) has increased over the past four years.

These products are now used in almost half the projects completed by respondents, who recognise their added-value and would be willing to spend 4-8% more for energy efficient products or products which are water efficient / recycled vs. standard alternatives (see Figure 4).

Energy efficient products are perceived as most important in France, where the introduction of new regulation is key in explaining this phenomenon. 'RT 2012' requires contractors to reduce energy consumption in all residential new build housing starting from January 2013. When contractors in France were asked about the products they found most innovative over the past 18 months, insulation products, heating pumps and recycled products featured high on the list.

Figure 4

Price Premium for Energy Efficient Products



Summary

These survey results demonstrate how contractor behaviour is changing under current market pressures:

- Pricing pressure is evident and unlikely to ease in the near term given the lack of market growth
- The internet is expected to become increasingly significant as a purchasing channel. Contractors are loyal to brands and are using the internet to shop around for better deals
- In countries where environmental regulations are being implemented, they are having a real impact on the supply market for "green" products. These products command price premiums over their traditional peers
- Contractors are shifting to independent merchants and online at the expense of national chains

In response to these dynamics, there are a number of strategies that building products manufacturers and merchants need to consider.

- Deploying a multi-channel sales approach and accompanying pricing strategy should be a matter of priority for manufacturers. A robust internet strategy and compelling offer will be increasingly important and will enable greater resilience to ongoing price pressure
- National merchants need to respond to their loss of contractor purchase share with a renewed focus on their product range and value for money to win back contractor spend. They also need an improved customer service model to address weaknesses in customer loyalty
- Both manufacturers and merchants should ensure environmentally friendly products are offered to take advantage of the price premium they command

The shifting dynamics of the residential building sector provide significant challenges and opportunities for both manufacturers and distributors as they struggle to grow revenues.

If you would like to discuss any of the issues highlighted in this paper, please contact us at the addresses overleaf.

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