

## Changing Contractor Behaviors Have Impact Across the Value Chain

The difficulties that the building products industry has faced during the past several years is well documented and has had a material impact on how contractors behave, what they value, where they buy, and how they are likely to act as the housing market begins to show early signs of stabilization and eventual improvement. To gain deeper insights into these issues, L.E.K. Consulting recently surveyed contractors across the United States to better understand the steps they are taking to weather the housing downturn and their expectations for the future. The L.E.K. Contractor Behavior Survey also highlights future implications for the channel and manufacturers.

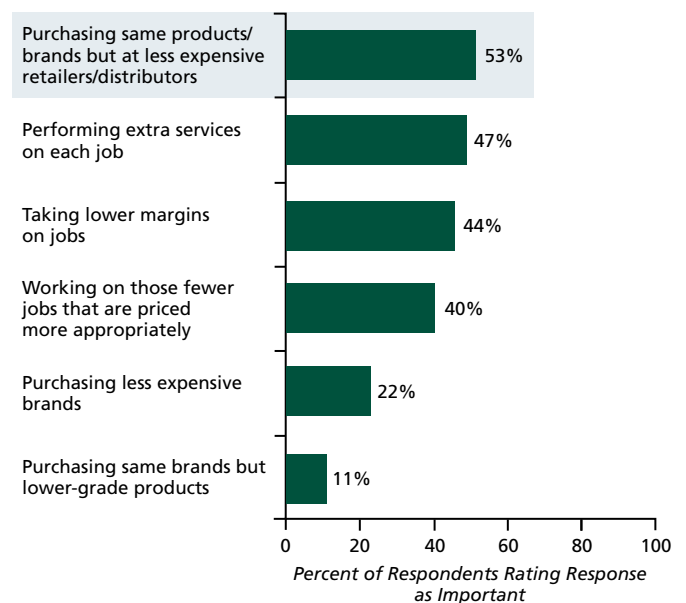
L.E.K. surveyed more than 500 contractors who have at least five years of experience and work at companies with at least three peak-season employees. The contractors were either responsible for, or directly involved in, purchasing decisions for their construction companies. The December 2010 survey reflects each U.S. geography fairly equally to provide a nationwide barometer of contractor sentiment and cuts across multiple contractor trades.

### Impact on Contractors and Builders: Soft Market Affects Everyone

The slowdown in the building and construction market forced contractors to make significant adjustments. Between 2006 and 2010, contractors experienced declines across the board – including number of jobs, revenue per project and number of staff. Revenue per job declined as much as nine percent on average in some regions, which caused contractors to compete more aggressively on price. Contractors claim that their percentage of bids lost due to price has nearly doubled since 2006.

In response, nearly 40% of contractors in select trade categories indicate that they are pursuing a broader range of services to keep their crews busy, led by contractors that specialize in dry-wall, masonry, siding and tile. Additional actions to combat pricing pressure include performing extra services and taking lower margins. What is most interesting, however, is that contractors' preferred method of responding to price pressure is to channel shop for trusted brands (see Figure 1).

**Figure 1**  
Contractor Responses to Price Pressure



Source: L.E.K. Consulting

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In fact, contractors are nearly 2.5 times more likely to switch channels to purchase a respected brand at a good price rather than trade down brands or quality. Some of this behavior may be influenced by homeowners who appear to be playing a greater role in product selection; nearly 30% of contractors feel that homeowner influence in product purchasing has increased since 2006. Despite a more pronounced role of the homeowner, contractors remain the most important product selection decision maker across nearly every type of job.

## Impact on Product Selection and Implications for Manufacturers

Economic realities have caused shifts in contractor product purchasing criteria and the increased importance on price is to be expected. Yet despite price pressure, durability remains the most important product selection factor as contractors want to prevent costly customer callbacks and avoid added or unexpected installation time driven by inferior products. Although these purchasing criteria follow a similar trend across most categories, the relative importance of price outweighs durability in categories with commodity-like properties (e.g., framing and insulation). Product availability also remains very important as contractors don't want to waste time waiting (or searching) for materials.

The industry has also seen a great deal of focus on energy efficiency and sustainability during the past few years. Contractors see a clear distinction between these trends. Energy efficiency is a material part of the product selection criteria and is much more important today than in 2006. And energy efficiency experienced the biggest relative increase in importance, after price. However, when looking at overall product selection criteria (not just changes in importance during the past four years), energy efficiency is only moderately important across product categories.

Sustainability, on the other hand, is one of the least important criteria overall. Its change in importance – while certainly growing during the past four years – increased less than the role that manufacturers' websites play in educating contractors about product selection and differentiation. With all the "green" hype during the past few years, it would appear to L.E.K. that much

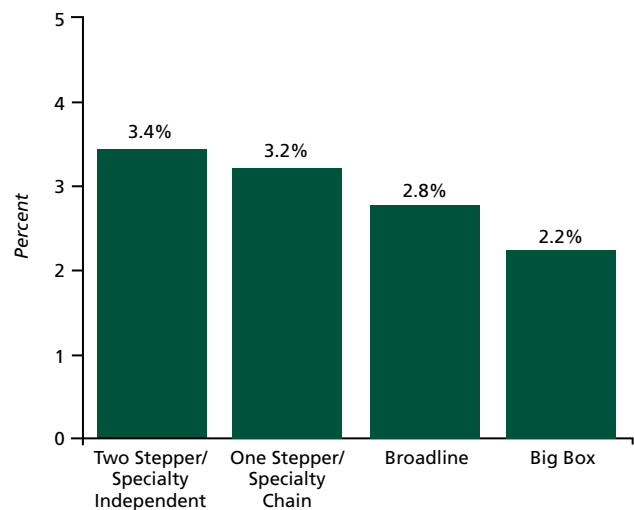
of this investment has made little impact in contractor behavior and was likely misdirected.

## Channels See Shifts

Contractors remain loyal to brands and find channel attrition the most common way to compete on price. This shift has funneled sales to big box and away from other channels across most categories. Despite the seeming lack of channel loyalty, there remains some degree of channel preference. L.E.K. measured preference by a willingness to pay a price premium for attributes associated with a specific type of channel, and found that contractors value two steppers and one steppers more than broadline and big box options (see Figure 2).

These pro channels are advantaged relative to big box on some of the most important traditional channel selection attributes – including delivery and contractor services. Yet, big box is closing this gap and competing more effectively on location, convenience and price. In fact, nearly 90% of contractors' rationale for shifting to big box in recent years is driven by either price or convenience.

**Figure 2**  
Loyalty to Channel – Percent Price Premium  
Contractors are Willing to Pay to Shop at a Channel



Source: L.E.K. Consulting

While big box may remain advantaged in terms of convenience vs. pro channels today, contractors expect to shift back to their

historically preferred channels as the housing market improves. When asked about their purchasing decisions by channel, contractors anticipate that their purchasing patterns in 2013-2014 will trend back to more pro-orientated channels. One steppeers, for example, are expected to recoup most of their share loss. Contractors state this channel shift will occur across nearly every trade category, and the greatest relative shifts are expected in roofing, carpentry, paint, siding, drywall, windows and doors.

The Internet is also playing a larger role in the channel. In addition to online sites playing a growing role in product selection, this trend is expected to increase in product fulfillment. While online sales represent a very small portion in most categories today, its share has doubled since 2006. And contractors across every category expect this channel to increase in importance. It is essential for both channels and manufacturers to carefully consider the Internet's role in reaching contractors and homeowners to complement their sales and marketing strategies.

## Implications and Priorities

L.E.K.'s findings clearly show that manufacturers with strong brands have more pricing power than originally thought, as contractors will "seek out" preferred products on sale across channels rather than turning to less expensive alternatives. Consequently, ceding price to own channel share is likely not a long-term value creating strategy.

To drive growth, OEMs need to continue to invest in contractor affinity and education programs while ensuring the highest performance on key product features such as reliability and durability. This is especially important as contractors have increased purchasing decision-making responsibilities.

Additionally, homeowners are also becoming more involved in product selection. As such, manufacturers should complement contractor-focused programs with homeowner marketing initiatives that raise brand awareness with consumers and underscore brand differentiation through education. In all cases, the Internet will continue to play a larger role in both brand awareness and sales, and should be addressed accordingly in future programs.

By understanding that many contractors gravitate toward channels that provide value-added services, distributors – either pro or big box – can strengthen their positions by identifying and targeting the most attractive contractor segments that will drive future profitable growth. Clearly price and promotion are still key purchasing considerations, and contractors have been lured by discounting to shift channels during the recession. But the L.E.K. Contractor Behavior Survey results indicate this is not a permanent shift.

Continuing to compete mostly on price and promotion – as opposed to offering real value geared at contractors needs – will inevitably result in adverse selection: you will keep the least attractive (and least profitable) contractor segments. However, channels that choose the right balance of brand and product line exclusivity with differentiated services will be well-positioned to enhance loyalty with their core customers and have the opportunity to replicate this success with other segments in the future.

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.

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