

**Joint Center for Housing Studies  
Harvard University**

**Achieving Scale in the Residential Remodeling Industry:  
Findings from Interviews with Industry Leaders**

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## **Abstract**

Due to the many obstacles to scale economies facing the residential remodeling industry, such as low barriers to entry, volatile business cycles, highly customized work, and difficulty attracting capital, the industry continues to be highly fragmented, with the vast majority of remodeling companies operating as relatively small, single-location businesses that likely will not experience any significant growth over their life-cycles. Yet, evidence suggests that remodeling firms able to overcome these obstacles enjoy significant benefits from scale. Better understanding of the ways in which remodeling companies are overcoming the many hurdles to scale, as well as how industry manufacturers, distributors and franchisors are supporting scale and consolidation efforts in the remodeling industry, should provide insights into how the industry is likely to evolve over the next several decades. This research relies on in-depth interviews with remodeling industry leaders who have successfully established larger-scale companies or are otherwise supporting scaling and consolidation efforts within the industry. The perspectives, strategies and approaches described herein are by no means intended to be exhaustive, but are rather a sampling of key views and methods as discovered through interviewing. Since the remodeling industry is so diverse, with business segments and market niches that cover the spectrum from full-service firms to specialty replacements and handyman services, there is no one-size-fits-all approach to achieving scale. Remodeling companies are employing a variety of scaling strategies that often involve strategic partnerships with nationally-known manufacturing and retail brands, franchisors, or investors. Major industry manufacturers, retailers, and franchisors are also playing significant roles in supporting scale opportunities of remodeling contractors.

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## **I. Introduction**

The Remodeling Futures Program of the Joint Center for Housing Studies has been conducting research on industry structure issues since the program's inception nearly twenty years ago.<sup>1</sup> Through this research, the Remodeling Futures Program has sought to better understand the evolving structure of contractors serving the residential remodeling market by investigating trends in contractor size, composition, concentration, consolidation, performance, and survivorship. Unlike the national homebuilding industry, which saw significant increases in scale and consolidation in recent decades, the professional remodeling industry continues to be highly fragmented: the vast majority of companies are relatively small, single-location businesses that likely will not experience any significant growth over the course of the business's life-cycle. These small-scale contractors focusing on local markets are thus highly susceptible to failure with each swing of the business cycle.

Yet, even though the vast majority of the remodeling industry is composed of relatively small businesses, there are many examples of companies that have successfully pursued the cost and efficiency benefits that typically occur with greater scale, such as improved costs of purchasing, marketing, and overhead, and improved productivity and efficiency through specialization of job functions. These remodeling businesses have achieved a size and geographical reach that far surpasses the industry average. Most of the major industry trade magazines publish annual lists of "top" remodeling companies and market leaders in terms of revenue and jobs. These "top" remodeling companies typically report annual remodeling revenues of over \$1 million, with the largest upwards of tens or even hundreds of millions.

While the evidence suggests that larger-scale remodeling firms enjoy significant benefits, the industry has remained fragmented due to the many obstacles to gaining scale, such as low barriers to entry, highly customized work, and difficulty attracting capital, to name a few. Understanding how remodeling companies are overcoming these major hurdles in their

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<sup>1</sup> For example, see: Belsky, Eric S., Mark A. Calabria, and Alfred R. Nucci. March 2001. *Survivorship and Growth in the Residential Remodeling Industry: Evidence from the Census of Construction*. Joint Center for Housing Studies Working Paper, W01-5; Will, Abbe and Kermit Baker. December 2007. *The Performance of Remodeling Contractors in an Era of Industry Growth and Specialization*. Joint Center for Housing Studies Working Paper, W07-8; and Joint Center for Housing Studies of Harvard University, *Improving America's Housing* reports: 1999, 2001, 2005, 2007, 2009, 2011 and 2013.

pursuit of scale economies should provide insights into how the industry is likely to evolve over the next several decades, as well as what opportunities exist for more widespread consolidation moving forward.

To this end, the Remodeling Futures Program conducted in-depth interviews with remodeling industry leaders including founders, presidents, and CEOs of larger-scale remodeling companies and franchisors, as well as directors of installed sales and contractor programs at manufacturers and distributors. These interviews concerned the benefits of, challenges to, and strategies for achieving scale. The main objectives of the research presented in this paper are, first, to explore and catalogue the various business strategies and approaches that remodeling companies are using to overcome the challenges of scaling a business to regional or even national levels in such a highly fragmented and volatile industry, and second, to examine how manufacturers, distributors and franchisors support scaling and consolidation efforts in the remodeling industry. Based on the insights gathered from this framework, the paper concludes by examining whether certain types of remodeling segments or market niches are more likely to be successful in establishing a larger-scale or even national presence, and how the structure of the remodeling industry might evolve over the coming decades towards more widespread scaling and consolidation efforts. Brief consideration is given to whether there are lessons from other similarly structured industries relevant to this area of research, and to whether there are scaling strategies or models that have not yet been tried or fully developed in this industry that might be pursued in the future.

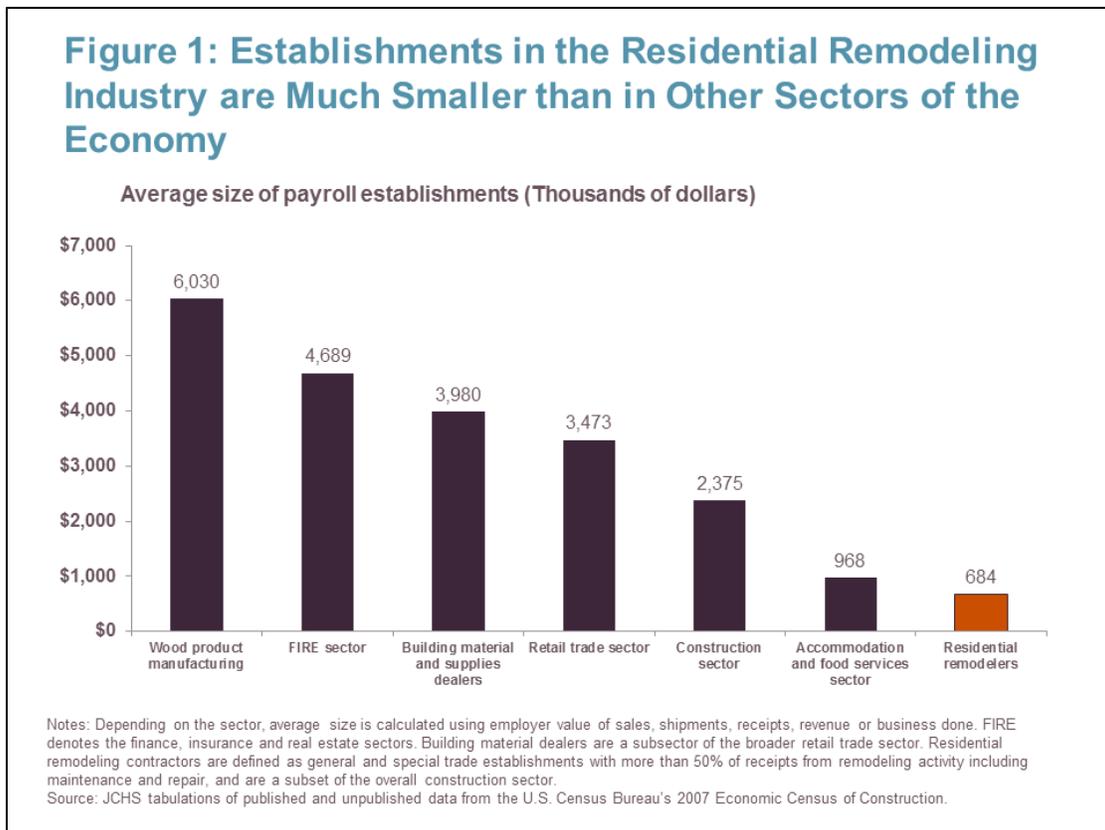
A key insight gained from these interviews is that successfully achieving scale in the remodeling industry has more typically occurred using strategies beyond the organic business expansion model. Instead, remodeling companies successful in expanding have used some combination of organic growth, vertical integration, and strategic partnerships with nationally known manufacturing and retail brands, franchisors, or outside investors, for example. Since the remodeling industry is so diverse, with business segments and market niches that cover the full spectrum from full-service and design/build firms to specialty replacements and handyman services, there is no one-size-fits-all approach to achieving scale, and companies are often employing multiple business strategies and arrangements either consecutively or concurrently

in their pursuit of scale economies. While the structure of the remodeling industry is complex and presents many obstacles to gaining scale, remodeling companies are finding significant benefits to scale. Moving forward, the industry is likely to continue evolving toward greater opportunities for scaling and consolidation.

## II. Challenges and Benefits of Economies of Scale in the Remodeling Industry

### *A. Industry Fragmentation and Major Obstacles to Scale*

Unlike many other sectors of the economy, the professional residential remodeling industry continues to be highly fragmented, where the vast majority of companies are relatively small, single-location businesses that likely will not experience any significant growth over the course of the business's life-cycle. According to the most recent Economic Census conducted by the U.S. Census Bureau, the majority of contractors primarily serving the residential remodeling market are smaller-scale firms. The average size of remodeling contractors in terms of annual revenue is significantly smaller than in other major sectors of the economy: one-third the size of firms in the broader construction sector, one-fifth the size of retailers and about one-tenth the size of wood product manufacturers (Figure 1). Indeed, residential remodeling contractors are even smaller in scale than the typical establishment serving the fractured lodging and food services sector.

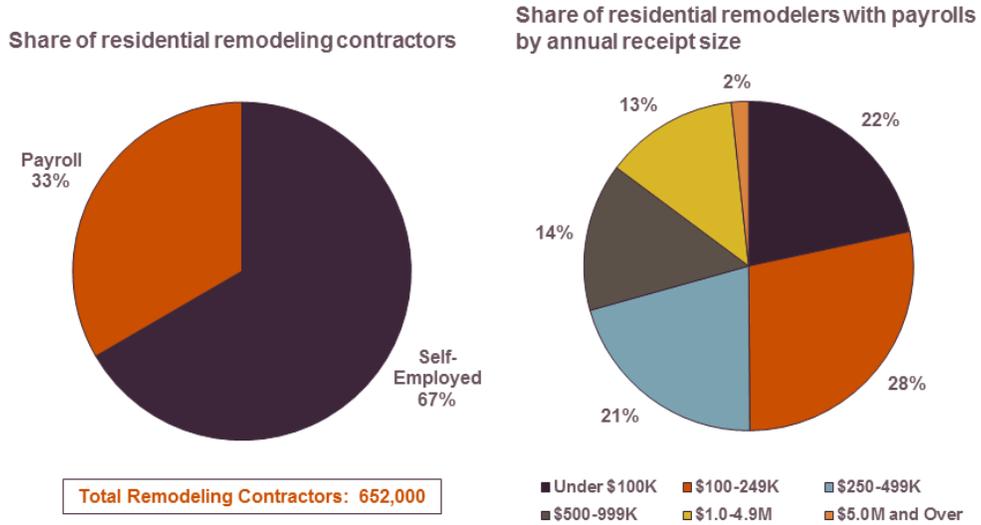


According to Joint Center tabulations of unpublished data from the U.S. Census Bureau's 2007 Economic Census and Nonpayroll Statistics, within the residential remodeling industry, two-thirds of the estimated 650,000 general and special trade contractors are self-employed, and fully half of establishments with payroll have total annual revenues of under \$250,000 (Figure 2). Compared to other segments of the residential construction sector, such as new homebuilding or building materials supply, the residential remodeling industry is significantly less concentrated. While the twenty largest companies account for over a third of total industry receipts in homebuilding and over half of total receipts in building materials supply, the twenty largest general remodeling contractors account for only five percent of total general remodeling receipts (Figure 3). The high fragmentation of the residential remodeling industry means that remodeling contractors have much more limited buying power and leverage with their suppliers than the more concentrated segments of the construction sector. With so many small contractors and such high fragmentation, it is not surprising that the failure rate for remodeling contractors is relatively large. Even during the last industry upturn, more than a third of remodeling contractors with payrolls failed between 2003 and 2007, and remodeling firms that started up in 2003 had a failure rate of over 50 percent by 2007.<sup>2</sup>

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<sup>2</sup> Will, Abbe and Kermit Baker. December 2007. *The Performance of Remodeling Contractors in an Era of Industry Growth and Specialization*. Joint Center for Housing Studies Working Paper, W07-8.

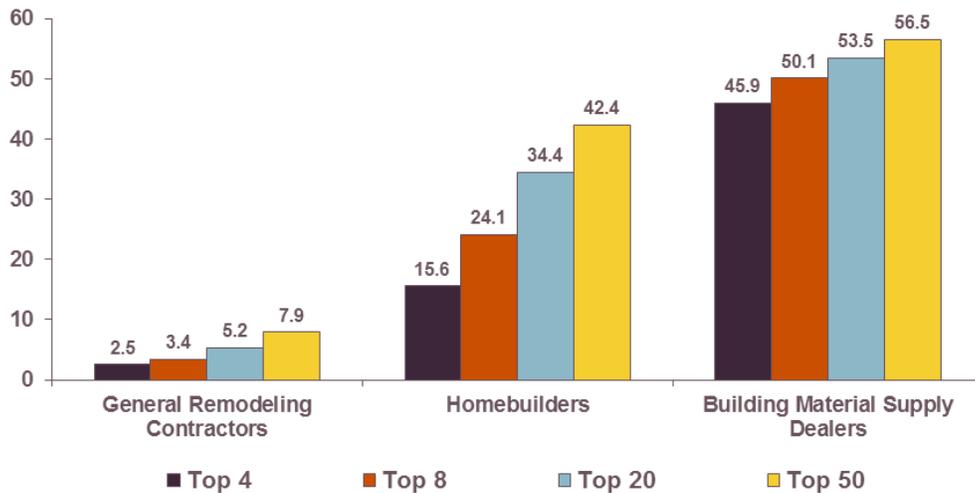
**Figure 2: The Remodeling Industry is Comprised of Large Numbers of Self-Employed; Even Payroll Contractors are Characterized by Smaller-Scale Firms**



Notes: Residential remodeling contractors are defined as general and special trade establishments with more than 50% of receipts from remodeling activity including maintenance and repair. Self-employed figures do not include remodelers reporting less than \$25,000 in gross receipts in 2007. Sources: JCHS tabulations of unpublished data from the U.S. Census Bureau's 2007 Economic Census of Construction and 2007 Nonpayroll Statistics.

**Figure 3: The Remodeling Industry Remains More Fragmented than Other Parts of the Residential Construction Sector**

Share of total receipts accounted for by the largest companies (Percent)



Sources: JCHS tabulations of the 2007 Economic Census and *Builder* magazine's 2007 Builder 100 list.

The structure of the remodeling industry is complex and has many obstacles to gaining scale. Distinct industry market segments range from general remodeling (including full-service and design/build) to specialty trades (such as roofing, siding, plumbing, and electrical) to maintenance and handyman repair.<sup>3</sup> Such complexity makes it challenging to create businesses that are easily replicable on a large scale. Other characteristics of the industry that present obstacles to scale include: low barriers to entry; extremely volatile business cycles; highly customized work; a lack of focus on business acumen by many contractors entering the industry mainly to practice their craft; excessive reliance on founders or key operators for the business's success; and difficulty attracting capital.

Of these, perhaps the most significant obstacle to achieving scale economies is low barriers to entry. Since very few resources are required to begin working as a contractor, residential remodeling is still very much a cottage industry with a large share of part-time and self-employed contractors and many start-up businesses. The ease of entry keeps the industry highly fragmented and highly competitive, both in terms of the sheer number of firms and in pricing. Established and professional remodeling businesses must compete with the underpricing of inexperienced start-up remodelers who may not even realize the unsustainability of such a strategy in the long run.

The low barriers to entry and aggressive competition go hand in hand with another major obstacle to scale: the inherent volatility of the construction industry. Indeed, the low barriers to entry and rather high failure rates of remodeling contracting businesses result in a great deal of churn in the industry, as a relatively large share of contractors enter and exit the industry with each new swing of the business cycle. Although specialization leads to a number

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<sup>3</sup> For the most part, contracting companies serving the residential remodeling industry can be divided into two main market segments: general, or full-service, and specialty remodeling. Full-service remodeling companies offer a broad range of products and services and typically coordinate the work of specialty trade subcontractors. By this definition, the full-service segment of the remodeling industry would include general contractors, design-build firms, and handyman repair firms. Specialty trade remodeling companies provide single products or trade, such as exterior replacements (windows and doors, siding, roofing, etc.), plumbing and electrical, painting, flooring, basement finishing, deck additions, kitchen and bath cabinet re-facing, or bathtub liners and surrounds. One could argue that even insurance restoration is part of the specialty segment because of its extremely narrow purpose and client base: disaster repair and insurance companies.

of efficiencies, remodelers often find it difficult to fully specialize in such an unstable business environment.

Unlike many other industries where the product or service can be easily standardized, in home remodeling the work is fundamentally highly customized. The perception that every remodeling job is different makes gaining efficiencies rather difficult, and it is certainly challenging to deliver a consistent customer experience under these conditions. Also, business culture, building codes, design and product preferences, and even equipment and materials are all very specific to local geographies and can differ substantially across the country. Such inconsistencies across regions are another barrier to efficiencies and scale.

Given the highly customized and relationship-based work of remodeling existing homes, it is not surprising that many contractors enter the industry mainly to practice their craft or skilled trade and not to simply operate a business. Yet skilled tradespeople may have very little formal business training in such areas as marketing, accounting, or finance, which is another challenge to gaining scale. Owners trying to manage a contracting business with limited staff might not have the time or resources to strategize about the growth of their business and the benefits of scale. Also, many founder/proprietors grow their remodeling businesses only enough to support a comfortable lifestyle, at which point they are content to maintain the size of the business and avoid the extra challenges of scaling further. Especially when business is good, it is hard for contractors to see why they should do anything differently with their business operations or strategies.

A final significant obstacle to achieving scale in the remodeling industry is difficulty in attracting capital. Bank financing is sometimes hard to access, with lenders discouraged by the high levels of volatility and risk in such a fragmented industry. Meanwhile, the greatest hurdle for outside investors or companies looking to acquire remodeling firms is that these businesses are often very dependent on the founder/proprietor for successful operation, in which case the proprietor is essentially seen as the primary asset of the business. Typically, investors seek businesses that offer scalable and replicable opportunities for profit, have good systems and processes in place to do so, and have a strong management team. Even the relatively modest profit margins and rates of return typically found in companies serving the residential

remodeling industry are not considered as problematic from the investor's perspective as the risk of taking on a business that is overly tied to one key operator. However, a lack of sophistication with finance and valuation of companies among remodeling business owners limits prospects for consolidation, because they tend to overvalue their companies by discounting this risk and so are not willing to consider acquisition and consolidation deals for amounts below their unrealistic expectations. Fundamentally, investors are looking for whether there is an opportunity to grow the business, either organically or through acquisitions, or to sell the business as a consolidation effort.

### *B. Benefits of Economies of Scale*

Certainly the remodeling industry is diverse and is faced with many obstacles to scale. Yet, remodeling companies able to overcome these obstacles are realizing considerable benefits. In its most basic definition, economies of scale refer to all of the cost and efficiency benefits that typically occur as a business grows larger. In the context of the remodeling industry, some of the major perceived benefits of scale include: improved costs of product purchasing, such as discounts for buying building materials in bulk or buying from an exclusive arrangement with a dealer or manufacturer; improved returns to marketing where a company can operate more efficiently by spreading out the fixed costs of marketing over increased sales volumes; improved benefits of overhead spending by similarly reducing the share of resources devoted to centralized business functions such as office space, human resources, and IT; improved costs of capital in the form of lower interest rates for bank financing and greater access to credit; and finally, improved productivity through specialization of job functions, where the company is able to retain devoted staff for accounting or sales, for example, instead of requiring employees to do many different job functions without the time or resources to master any one of them. But even beyond these naturally occurring benefits to scale, why should companies pursue economies of scale in the remodeling industry?

The evidence for the benefits of scale in the remodeling industry is compelling. Certainly in such a fragmented and volatile industry,<sup>4</sup> remodeling companies that achieve economies of scale and become larger and more efficient should also become more competitive with increased market power. And in the end these companies should be in better positions to survive the inherent volatility in this industry. Comparing the revenue growth of larger-scale remodeling companies to that of the industry as a whole shows that larger-scale remodelers benefit from significantly stronger revenue growth. Where the average revenue of all residential remodeling contractors increased less than 18 percent in inflation-adjusted terms during the last industry upturn, between 2002 and 2007, larger-scale firms with annual revenues of approximately \$1 million or more increased their average revenue by over 30 percent during the same period. Additionally, larger-scale remodeling contractors benefit from higher revenues per employee, which implies that they enjoy greater labor productivity (Figure 4). While an admittedly crude measure of efficiency and productivity,<sup>5</sup> the trend is obvious that larger remodeling businesses are benefiting from scale by earning greater revenues per employee.

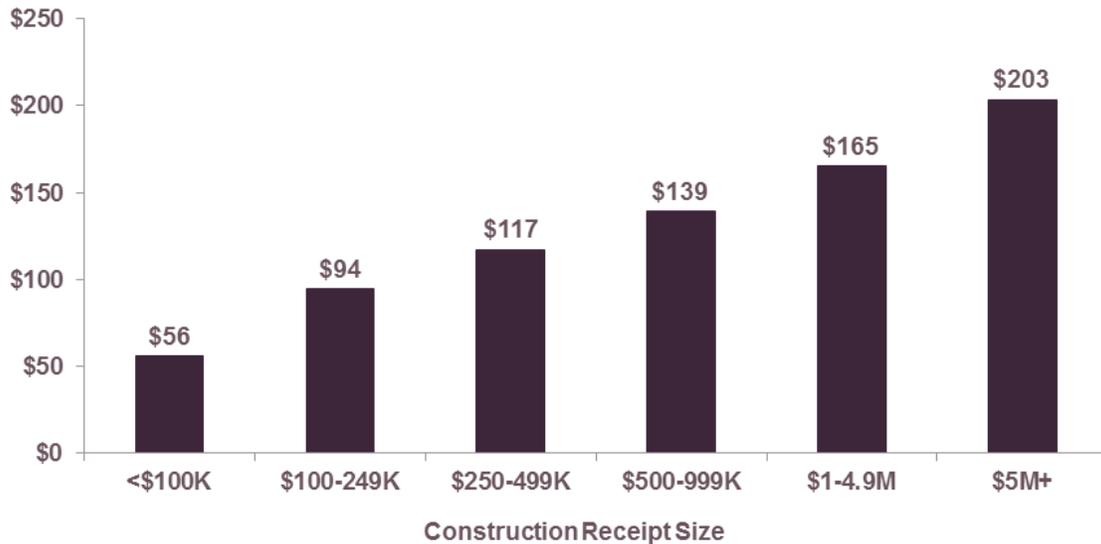
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<sup>4</sup> Will, Abbe. August 2008. *Understanding Remodeling Cycles*. Joint Center for Housing Studies Working Paper W08-6.

<sup>5</sup> This analysis does not include work subcontracted out or account for part-time employees, where smaller firms are more likely to have more part-time workers. It also does not take into account differences in the type of remodeling business, such as full-service or specialty firms.

## Figure 4: Larger-Scale Remodeling Contractors Benefit from Higher Revenues per Employee

Average construction receipts per employee for residential remodeling establishments  
(Thousands of dollars), 2007

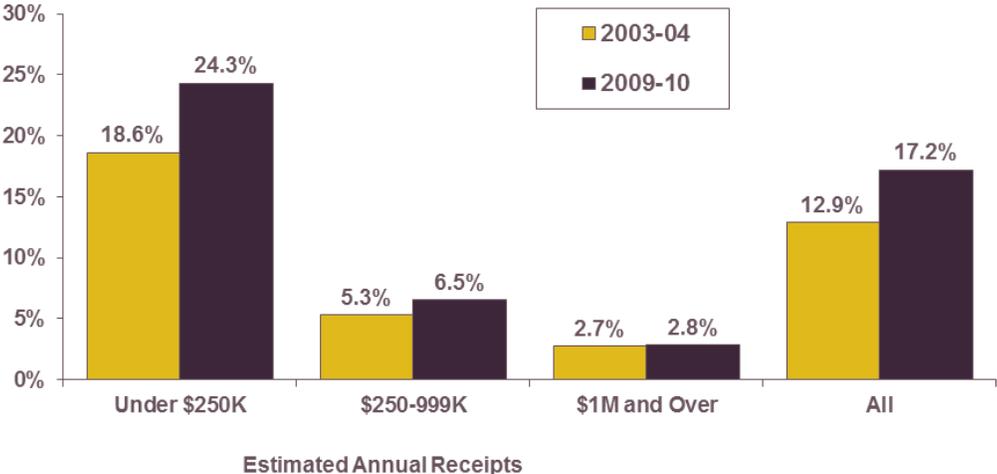


Notes: Residential remodeling contractors are defined as general and special trade establishments with more than 50% of receipts from remodeling activity including maintenance and repair.  
Source: JCHS tabulations of unpublished data from the U.S. Census Bureau's 2007 Economic Census of Construction.

Furthermore, there is evidence that larger-scale remodeling firms suffer significantly lower failure rates across the rocky business cycle. Remodelers with estimated receipts of \$1 million or more during the beginnings of the last industry upturn in 2003-04 had a failure rate of only 2.7 percent that year, and their failure rate remained essentially unchanged during the cyclical downturn in 2009-10 (Figure 5). These low and stable failure rates for the largest remodelers are in stark contrast to the roughly 20 percent failure rates for smaller remodeling businesses. With the efficiency gains that come along with achieving scale economies, larger remodeling companies seem much better equipped to ride out volatile business cycles. Overall, it appears that larger-scale remodeling firms that overcome obstacles to scale are enjoying significant benefits, including increased revenue growth and labor productivity, and low and stable failure rates across business cycles.

**Figure 5: Larger Remodeling Contractors Experience Low and Stable Failure Rates Across the Cycle**

Percent of general remodeling establishments ceasing operations



Source: JCHS tabulations of U.S. Census Bureau, Business Information Tracking Series.

### **III. Perspectives on Pursuing and Supporting Scale Economies in the Residential Remodeling Industry**

To date the home remodeling industry has experienced very little concentration or consolidation due to the many challenges businesses face in trying to achieve scale economies, as well as the difficulties standardizing an industry that encompasses so many distinct niches such as design/build, insurance restoration, specialty replacements, and handyman services. Even so, the perceived cost and efficiency benefits of scale economies have encouraged many remodeling contracting businesses to pursue scale strategies that grow their operations far beyond the average-sized firm in the industry.

Contractors have not been alone in their pursuit of scale however. Building product manufacturers and distributors, which typically serve the residential and nonresidential sectors of both the new construction and remodeling industries, have played a greater role in recent years in supporting efforts at achieving scale economies in the home remodeling industry. These manufacturers and distributors have already benefited from a streamlined supply chain in the other construction sectors, and they recognize that similar efficiencies are to be gained in the home remodeling industry. Also, as a mostly smaller-scale fragmented cottage industry, residential remodeling has attracted franchising, licensing, and related efforts,<sup>6</sup> especially for the more focused single-line specialties such as siding, painting, or deck additions. The proven, replicable business model and support of a franchise company offers an opportunity for faster and more predictable growth not only to established remodeling companies, but also to business- and marketing-savvy entrepreneurs who may not have a remodeling or construction background.

The research sections below present a framework for cataloguing the main strategies and approaches used to pursue or support scale economies and consolidation from the perspectives of remodeling contractors, manufacturers and distributors, and franchisors. The perspectives and approaches discussed are not intended to be a definitive or comprehensive

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<sup>6</sup> Franchising and licensing are used here and elsewhere in the paper as representations of a variety of related concepts for business agreements between legally independent entities that expand the distribution channels of a business to new markets. Franchising, licensing, distributorships, dealerships, and affiliate agreements are common examples of such business agreements, though each method may have unique legal terms and conditions. Franchising in particular is heavily regulated at the state and federal level.

list of those operating in the residential remodeling industry; they simply reflect what was uncovered through interviewing. Similarly, the main perspectives and strategies for scaling and consolidation are not mutually exclusive, and readers will notice a great deal of overlap among them. For example, independent remodeling contractors might pursue scale economies through strategic alliances with a manufacturer by participating in its installed sales programs, which in turn might take the form of a franchising or dealership arrangement. Another variation of the contractor-manufacturer alliance is illustrated by installation services companies, which operate in some ways like traditional remodeling companies but specialize in facilitating and managing installed sales programs for national manufacturers and distributors. In describing the various strategies used by remodeling contractors, manufacturers and distributors, and franchisors to either pursue or support scale economies in the home remodeling industry, brief profiles of companies interviewed are provided to help illustrate each strategy or perspective.

#### ***A. Remodeling Contractors***

Residential remodeling contractors are pursuing scale economies using a variety of business strategies. While the organic model of business expansion and acquisition is occasionally pursued with success, more typically remodeling contractors that successfully establish a larger-scale presence in the industry are using strategies or approaches that involve some form of partnership or alliance. Certainly, with such diverse business segments, there is no one-size-fits-all approach to achieving scale in the home remodeling industry, and in fact companies are often employing multiple types of business strategies and arrangements either consecutively or concurrently to grow their business toward a regional or even national presence. Below are descriptions of several key strategies, gleaned from interviews, used by contracting firms to overcome barriers to scale.

1. Organic expansion and acquisition: Organic growth approaches involve building a business from the ground up and developing it over time by expanding into new markets or services, or by acquiring complementary or related businesses. In the remodeling industry, pure organic growth strategies very rarely result in remodeling contractors achieving significant scale

or reach beyond local markets, and it is telling that no remodeling companies have achieved a national presence using strictly organic growth methods. Acquisitions, in particular, have not been very common in the remodeling industry for a variety of reasons, including availability and accessibility of capital and the prevalence of businesses that rely too heavily on founders or key operators, making the business less attractive to investors. These smaller-scale, often family-owned businesses also tend to overvalue their companies and so are not willing to consider most acquisition offers. More typically, acquisitions occur when the founder or key proprietor is looking to retire or otherwise exit the industry.

The key to growing a company through organic expansion and acquisition is a strong management team. Before expanding, it is critical to have a long-term, trusted manager in place that knows the company culture and processes well and can oversee the transfer of this information to new company locations. This requires, in turn, the preparation of well-documented company processes, procedures and management systems to be instituted across sites. Such management systems, by easing the transfer of a company's culture and processes to new expansions or acquisitions, also add value to the company. Below are two examples of remodeling companies, one from the full-service and one from the specialty segment of the industry, that have achieved large regional presences mostly through organic expansion and acquisition. Differences in the scale and reach achieved by these two companies also illustrate the vast difference between operating a business in the full-service vs. specialty segments of the remodeling industry.

*Neil Kelly, Inc., a \$20 million family-owned design/build company with five locations in the Pacific Northwest, is well-known and regarded in the home remodeling industry as a highly successful general contracting firm that has grown largely through organic means. The company was first established nearly seventy years ago, a distinction in itself considering the relatively high rate of failure for remodeling contractor establishments in any given year. In growing the company over the years, Neil Kelly has taken advantage of opportunities to acquire local competitors and related companies whose founders were retiring or otherwise leaving the industry. Key growth strategies have also involved*

*diversifying the company's core design/build business to include energy efficiency retrofits, home repair and small projects, and cabinet manufacturing. While a very successful regional remodeling company, Neil Kelly, Inc. recognizes the challenges of growing the company toward a national presence through organic growth strategies. Taking the company national would mean either bringing in outside investors or selling the company to an already established national remodeling firm, but either way would result in giving up control over the company brand.*

**Power Home Remodeling Group** is a \$245 million specialty replacement firm focusing on windows, siding, and roofing with eight locations serving thirteen states in the Northeast, South and Midwest regions of the country. Power Home Remodeling Group's expansion was strictly organic in that it self-funded the building of new locations from the ground up, without pursuing acquisitions or drawing on outside investment. The company was founded over twenty years ago, and for its first decade operated as a window marketer and dealer before moving into installation services and expanding its product line. Ultimately, the company's successful scaling of their sales and marketing practices made possible its expansion into installation services. Finding another already established installation company that could keep pace with their sales and marketing was not only unrealistic, but more importantly, Power Home Remodeling Group wanted to retain control over the entire sales and installation process in order to ensure quality customer service and experience.

2. Vertical integration: An effective strategy for growth in many industries is vertical integration, in which a company owns and controls part or all of its supply chain from the manufacturing of inputs to the distribution of final outputs to end buyers. In the home remodeling industry, vertical integration has more often occurred with specialty replacement companies, such as those replacing windows, siding, or cabinetry. A key advantage of a vertically integrated replacement company is the proprietary or private label products manufactured by the firm, which provide exclusivity and distinction in such a highly competitive

industry. Having control of the manufacturing process of an exclusive product is critical for guaranteeing quality and supply volumes, controlling input and output costs, and minimizing the time between customer ordering and installation. Overall, vertical integration adds significant value to a specialty remodeling company because of the greater infrastructure, business processes, and human resources involved. Vertically integrated companies are thus in a stronger position for outside investment, mergers or acquisitions, although availability and accessibility of capital for becoming vertically integrated remains challenging in this industry.

*There are many examples of specialty remodeling companies that have vertically integrated their manufacturing and installation of home improvement products, including many of the largest companies listed on the industry's annual top remodeler lists as well as several companies interviewed for this project: **American Exteriors, NEWPRO, and US Home Systems.** Both American Exteriors and NEWPRO are specialty replacement window, siding and roofing firms. US Home Systems is a specialty kitchen and bath cabinet re-facing company that first partnered with and was then acquired by The Home Depot. For larger-scale specialty companies, manufacturing one or more product lines allows the company to control product distribution and quality.*

3. Strategic alliances: The broad umbrella of strategic arrangements or partnerships appears to be one of the most commonly used strategies for achieving scale economies in the residential remodeling industry. When expanding into new markets, building brand awareness and consumer trust takes significant investments of time and money. Securing a strategic alliance with a long-standing nationally-known manufacturing or retail brand, such as an exclusive licensing agreement to sell, furnish, and install products and projects reduces this effort: it can provide instant name recognition and credibility with consumers, who, given the same quality and price, will choose the brand with which they are already most familiar. One industry leader referred to such an arrangement as essentially “renting a brand” from already well-established national manufacturers and retailers. While it is certainly possible to grow a large-scale operation across states or regions organically and without such strategic alliances,

this will be a much slower and more expensive process to build a brand in each new market. Strategic alliances effectively provide remodeling contractors with instant access to a high volume of quality leads in new markets. In the examples below, two remodeling companies formed strategic alliances with a big box retailer, and the third with a specialty product manufacturer, in order to quickly and efficiently expand their business volume and reach.

***Statewide Remodeling** is a \$40 million full-service remodeling company with five locations across Texas. The twenty-year-old company started out as a specialty exterior replacement firm and grew organically by expanding product offerings before turning to strategic partnerships with major national distributors such as Sam's Club and The Home Depot. The reason for pursuing installed sales licensing agreements was to acquire high quality leads and low-cost entry into new markets. For the cost of the licensing fees with the distributors, Statewide Remodeling receives exclusive rights for the sale and installation of various home improvement products, and the ability to generate a high volume of leads through their in-store promotions staff and the distributors' store associates. This gives Statewide Remodeling the ability to move into new markets efficiently, since marketing costs and brand recognition through the distributor arrangement are already a known factor. Statewide Remodeling's installed sales arrangements have generated significant new business volume for the company.*

*Another example of a remodeling company pursuing strategic alliances is that of **US Home Systems**, a specialty kitchen and bath cabinet re-facing manufacturing and installation firm that eventually pursued an exclusive partnership with The Home Depot, which has since purchased the company. What US Home Systems recognized over time was that the only way they could expand their business toward a national scale was to attach themselves to a nationally-recognized brand. With an installed sales arrangement, US Home Systems immediately saw a significant increase in volume of leads and sales. While US Home Systems was able to scale their business up to sixteen locations prior to its alliance with The Home Depot, its organic expansion into new*

*markets was slow and expensive; each new market required the investment of significant time and money in brand building. Aligning themselves with a major brand made the company's expansion much more efficient.*

***LeafGuard by Beldon***, a \$65 million specialty replacement gutter company, is an example of a remodeling company pursuing a strategic partnership with a manufacturer in order to grow their company in new markets. The Beldon company began nearly seventy years ago in San Antonio, Texas as a roofing and supply firm. In response to the severe economic recession and banking crisis of the 1980s, Beldon sought to diversify through new product lines and across geographies so as not to be overly dependent on the economic health of one market or one region of the country. In 1995, the company partnered with a manufacturer to operate as an authorized dealer of a new patented gutter system known as LeafGuard. Through a combination of organic expansion and acquisition of struggling dealerships, LeafGuard by Beldon now operates in sixteen major markets in each region of the U.S. and one location in western Canada. The key to Beldon's successful expansion and turnaround of struggling dealerships was the company's strong focus on marketing and sales of its unique product where other more traditional home improvement businesses were not so marketing-oriented.

**4. Outside investment:** Pursuing outside investment—through private equity partnerships, for example—provides a company with an influx of working financial capital for expanding into new markets, developing additional lines of business or products, or restructuring operations or management to better foster growth. Though considered a highly effective and even necessary strategy for growth, especially toward a national presence, securing outside investment has been relatively uncommon in residential remodeling because investors are deterred by the high-risk nature of such a volatile and fragmented industry. Of the remodeling companies interviewed with experiences using private equity investment, no clear consensus emerged on whether outside investment in remodeling companies is on the whole a beneficial strategy for scaling. Some remodeling companies cited the human capital impact of

outside investors as a major benefit, especially in terms of providing sophisticated financial acumen and best practices development, while other firms had difficulty adjusting to the loss of control over decision-making and business strategy.

*American Exteriors is a \$30 million vertically-integrated custom window and siding replacement firm with nine locations across the Midwest and Rocky Mountain regions. Like most large-scale specialty replacement firms interviewed for this project, American Exteriors acknowledged that the company's operations are more akin to a direct marketing company than a traditional remodeling contractor. This again emphasizes the importance of professional sales and marketing for achieving scale economies, especially for specialty replacement companies. Through successful marketing and organic expansion, American Exteriors was already well-established, with multiple locations across several regions of the country, by the time the company sought outside investor involvement. With a business model that had already proven to be both scalable and portable, American Exteriors was especially attractive to outside investors. In seeking outside investment, the company wanted to secure access to financial capital otherwise unobtainable for the firm and also to gain the human capital of private equity partners with more sophisticated business and financial skills and expertise. Such an investment of financial and human capital helped American Exteriors expand into new markets and quickly gain market share without having to wait through long incubation periods for name recognition and brand awareness, which normally requires considerable investments of time and money.*

5. Labor development: Mastering the training and development of the business skills of employees is critical for achieving scale in the remodeling industry. Given the industry's fragmented nature, the pool of candidates with experience working in large-scale remodeling companies is relatively small. So remodeling companies looking to grow must bring employees in at entry level and develop them over time to manage and lead the various areas of the business. While much of the business, such as sales, customer service, and project scheduling

and management can be operated by employees without a construction background, it is especially important for the success of the business that employees in these positions be hired at entry level and trained in company-specific systems and culture. Yet, even when acquiring new talent at the entry level and developing them within the company, remodeling firms are noticing a worrisome trend: these employees are often still not reaching the business and leadership skill levels of key operators and senior management, unless the management team is able to make an effort at providing employee mentoring opportunities to reach such skill levels.

***System Pavers** is a \$67 million specialty paving and outdoor living systems company with nine locations across California, the Pacific Northwest and Colorado. The company initially pursued a franchising model for expanding into new markets, and in doing so System Pavers had to document, systemize and standardize its business procedures, as well as create a thorough training program for franchisees. Ultimately, franchising was not successful for the company because of difficulties integrating the cultures of already established independent contractors into its own business model and systems, but this experience emphasized the importance and value of rigorous and comprehensive employee training programs for developing future leaders. System Pavers established the System Pavers University, a systematic hands-on training, instruction and continuing education program for all employees, from salespeople and designers to field supervisors and branch managers. Through System Pavers University, employees become deeply entrenched in the company's systems and culture, and eventually the trainees become future trainers and leaders. In this way, all managers must be coaches and mentors and contribute to building and developing a team of capable employees that will support business moving forward.*

***Paul Davis** is a franchisor in insurance restoration services, with three hundred franchisee locations in forty-seven states. Due to the complexity of full-service property damage and disaster repair work, Paul Davis has always sought quality over quantity in expanding its franchise network. As the company grew over time and added more*

*systems and services, Paul Davis recognized the necessity of investing in substantial training programs for each new franchise location. To provide this level of training and guidance, Paul Davis established a state-of-the-art National Training Center, where franchisees receive hands-on training and instruction in industry equipment and techniques, certification requirements, business management, customer service procedures, and marketing strategies. Such a strong focus on training and instruction is costly for Paul Davis, but necessary for successful operation of its franchises. Being able to offer this level of training to franchises is one of the biggest benefits of scale for Paul Davis, and it will continue to be a keystone for the company moving forward. As a large-scale franchisor, Paul Davis provides other important benefits to its franchisees: it gives them a recognizable brand, promotes innovation, and maintains best practices inside the franchise network.*

## **B. Manufacturers & Distributors**

Building product manufacturers and distributors, which typically serve the residential and non-residential sectors of both the new construction and remodeling industries, have been taking on greater roles in recent years supporting efforts at achieving scale economies in the home remodeling industry. These manufacturers and distributors have already benefited from a streamlined supply chain in the other construction sectors, and they recognize that similar efficiencies could be gained if the home remodeling industry were more consolidated as well. Manufacturers and distributors with a regional or national reach have begun tailoring their businesses to develop stronger and more direct relationships with established remodeling contracting businesses through installed sales arrangements and certified or preferred contractor programs. Both methods of partnering are mutually beneficial: they allow manufacturers and distributors to increase their market share and sales volume, while also helping remodeling businesses to grow and develop.

1. Installed Sales: Installed sales initiatives come in a variety of forms. The manufacturer or distributor may use in-house labor, but more commonly partners with company-trained and

authorized independent remodeling contractors to sell, furnish and install home improvement products and services. Often, installed sales arrangements occur through a licensing or related business agreement with independent remodeling contracting businesses, in which the manufacturer or distributor provides high volume and high quality leads for a negotiated fee or share of revenue generated. Some manufacturers have pursued franchising of installed sales as an additional method for distributing their product to market, while other manufacturers and distributors rely on third-party installation services companies. These third-party service companies essentially act as the facilitator and manager of installed sales initiatives for national manufacturers and distributors by providing their consumer leads to qualified, local, independent remodeling contractors.

*Many national building product manufacturers and distributors have pursued installed sales initiatives over the years: for example, window and door manufacturers such as Pella Corporation and Andersen Corporation, and major retailers such as The Home Depot, Sears, and Costco. Another interesting example is **Masco Contractor Services® (MCS)**, a division within the installation services business segment of building product manufacturer Masco Corporation. MCS has approximately two hundred branch locations in or near most major metropolitan markets across the nation and provides installed sales mainly of insulation, but also of gutters, fireplaces, garage doors, closet shelving and storage systems, and shower enclosures. All of MCS's locations are company-owned (though they often operate under local business names), and were mostly acquisitions of already established local and regional insulation specialty and building product companies. In this way, MCS combines the advantages of local home improvement contractor relationships and experience with the resources and capabilities of a national organization. While MCS primarily sells installed products to the new home construction market, a weakened homebuilding market in recent years has led it to expand its services to the residential retrofit market, including several energy efficiency initiatives. According to recent estimates, the repair and remodel services of Masco's Installation*

*and Other Services business segment, which includes MCS, amounted to over \$250 million in sales in 2013.<sup>7</sup>*

**Owens Corning® Basement Finishing System™** is a specialty franchisor of a basement finishing system with nine franchise locations serving markets across the Midwest, Northeast and mid-South regions of the country. Owens Corning created its innovative product and system to solve the problem of the unfavorable environmental conditions of basements, which are inherently dark and damp and often foster mold and mildew growth when finished and heated using traditional organic building materials. Owens Corning developed major improvements in basement finishing with its inorganic and highly insulating building material and modular system, which keeps the home foundation accessible and compresses the installation time to less than two weeks, compared to months for a standard construction process. Owens Corning decided that a franchising model would be a better strategy than conventional distribution channels for conveying the many unique features and benefits of such an innovative and sophisticated product and system. Successful franchisees are already established home improvement businesses, with highly structured processes for sales, marketing, training, and installation. Typically, specialty replacement contractors such as windows and siding remodelers fit these criteria well, especially with their focus and skill in marketing and sales techniques. Franchisees are offered multi-year agreements and exclusive territories, as well as the added benefit of being in business with the nationally recognized and trusted Owens Corning brand.

**RF Installations, LLC (RFI)** is a \$40 million installation services company with a network of over 1,500 installers operating in forty states nationwide, including most major metro areas. RFI is the installation partner of several national manufacturers and distributors, including the Home Depot, Andersen Windows & Doors, and 84 Lumber, and provides installation services for more than twenty specialty replacement home improvement

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<sup>7</sup> Masco Earnings Presentation, Fourth Quarter 2013. February 10, 2014.

*products such as doors, windows, siding, and kitchen cabinets. RFI is the result of several mergers and acquisitions of installation companies and is currently owned by a private equity firm. RFI installers are essentially subcontractors to the company, and range from self-employed contractors to larger-scale full-service remodeling companies. RFI seeks installers that are skilled carpentry professionals and also possess strong business and technology skills, because RFI relies heavily on technology systems and processes to manage, monitor, and measure all aspects of the installation jobs to ensure efficiency and customer satisfaction.*

2. Certified/Preferred Contractor Programs: Certified or preferred contractor programs foster scale economies of remodeling contractors by providing training, IT support, and marketing and business development assistance. Already well-established remodeling businesses can leverage their status to distinguish themselves in local markets and grow faster. Preferred contractor programs are mutually beneficial arrangements where the manufacturer or distributor can leverage its size and resources to increase the business of their remodeling partners, which in turn increases the manufacturer's or distributor's order volume. One of the biggest benefits for remodeling contractors who participate in preferred contractor programs is the unique distinction of being manufacturer trained and approved, which helps remodelers to differentiate their business in highly competitive markets. Additional benefits to the remodeler include support in lead generation (often through the manufacturer's or distributor's website), marketing, website design, product installation training, business technology such as project management software, and consumer financing. Many preferred contractor programs are designed to extend or enhance the current business of already established remodeling contractors, while other programs require contractors to commit to focusing their business on only one line of specialty trade, which may be too great a risk for smaller-scale contractors serving such a volatile industry.

***GAF**, a \$3 billion roofing materials manufacturer, established a certified contractor program seventeen years ago in order to create more direct relationships with*

*contractors and to help drive education and better business practices in the roofing contractor community. The overarching goal of the program is for GAF to help contractors build their business. Specifically, GAF partners with contractors to help generate quality leads, reinforce trust with their customers, close more sales, reduce costs, and increase capabilities. The program's scope goes well beyond promotional incentives. It also includes education about best practices and business development training through GAF's Center for Advancement of Roofing Excellence (CARE), and unique programs with national vendors for consumer financing options and discounts on vehicles and cell phone services, for example. A major feature of GAF's certified contractor program is the provision of enhanced warranties to homeowners covering the materials and workmanship of its certified contractors, and on their top-tier warranty, an inspection of each roof by GAF. This industry-leading warranty is a critical differentiator for contractors in such a competitive industry, and provides peace of mind for the homeowner. GAF is very particular about accepting contractors into its program: it requires contractors to have been in business for a minimum of three to five years (depending on their certification level), proof of workman's compensation and liability insurance, good standing with the Better Business Bureau (BBB), and a good credit rating with their primary distributor. Typical GAF certified contractors are exterior replacement businesses (usually specializing in some combination of roofing, siding and windows) with annual revenues under \$5 million and serving a single or limited market area. GAF believes that a significant portion of company growth in recent years has been primarily driven through its certified contractor programs.*

**Wellborn Cabinet Inc.** *is a manufacturer of kitchen and bath cabinetry and closet storage with nearly nine hundred dealers across the U.S. About five years ago, Wellborn established a comprehensive program for providing smaller-scale full-service remodeling contractors the training and assistance needed to specialize their business in kitchen and bath remodeling. Wellborn believes that remodeling contractors can achieve accelerated growth compared to their more full-service competitors by focusing their business, and*

*this can be accomplished more efficiently and effectively by partnering with and leveraging the resources of the manufacturer and its kitchen and bath dealers. Wellborn thus facilitates partnerships between its kitchen and bath dealers and authorized remodeling contractors for use of showroom space and design services. Wellborn also offers authorized contractors intensive training in and tools for business systems and technology, project management, design, and marketing. Wellborn seeks to partner with already established professional remodeling contracting companies that are typically full-service contractors wanting to specialize in kitchen and bath remodeling. Wellborn's authorized contractors have average revenues of \$750,000.*

### **C. Franchisors, Licensors & Related Enterprises**

Traditionally operating as a mostly smaller-scale, fragmented cottage industry, the residential remodeling industry has attracted a variety of franchising, licensing and related business agreement efforts, especially for the more focused single-line specialties such as siding, painting, flooring, or decks. Franchising is a well-established scaling strategy in many similarly structured industries, and allows a business to quickly expand its brand recognition and reach without the challenges of managing each independently-owned and operated franchise location. While in some cases, franchisors are partnering with already established remodeling companies to help grow their business faster and more predictably through the proven, replicable business model and support of a franchise company, more often franchisors are seeking to expand their operations and brand by partnering with business- and marketing-savvy entrepreneurs, who may not necessarily have a remodeling or construction background. Franchisors are looking first and foremost for leaders with strong business acumen, as opposed to trade skills, because sales, marketing, management, and leadership skills are more critical for successfully operating a franchise business.

Franchising in the remodeling industry seems to be more successful with single-focus or specialty businesses such as windows, siding, flooring, or painting, which are easier services to standardize and streamline. In general, franchising full-service or handyman services is much more challenging, because the sheer variety of products and projects makes standardization

and scheduling challenging. Again, a franchising strategy is mutually beneficial to the franchisor company, which is able to quickly expand its brand and market reach without investing significant capital in building or acquiring new locations, and the franchisee company, which gains a recognized brand name, proven business model, ongoing training and marketing support, and access to a peer network of franchisees for best practices advice and support. A related strategy for remodeling companies to expand their reach, but with significantly less commitment and oversight, is to license individually trademarked business systems or procedures—for accounting, estimating or managing clients, for example. Instead of the full benefits and support offered by the franchise model, a licensee gains only limited components of a larger business model to be incorporated into an otherwise fully independent remodeling business.

***FirstService Brands** is the property services subsidiary of the FirstService Corporation, a publicly-traded international real estate services company, and is a franchisor of home and property improvement companies including California Closets, CertaPro Painters, College Pro Painters, Floor Coverings International, Paul Davis Restoration, and Pillar to Post. FirstService Brands generates approximately \$1.25 billion in annual revenues serving the residential and commercial remodeling industries in North America. In the experience of FirstService Brands, the narrower the focus of the business being franchised, the more efficient and successful the franchise will be in scaling. Even Paul Davis Restoration, which offers a broad range of insurance restoration services, has a very narrowly focused client—the insurance company—and highly systematic processes for working quickly and efficiently with clients to restore damaged properties. As a large-scale franchisor, FirstService Brands provides significant investments and resources to independent business owner franchisees, playing a role in the remodeling industry similar to that of private equity investors. Although many of the activities of the remodeling industry ultimately depend on skilled labor, strong leadership and business acumen are the most important factors for successfully scaling in this industry.*

#### **IV. Key Insights from Interviews with Remodeling Industry Leaders, and Thoughts on Future Prospects for Ongoing Scaling and Consolidation**

While companies serving the residential remodeling industry face many obstacles to gaining scale, those remodelers able to overcome the challenges are finding a variety of benefits, including increased revenue growth and labor productivity and more stability across business cycles. Industry leaders reported that some of the biggest advantages of scale for their companies were improved buying power, lower costs of materials, efficiency of centralized accounting and management, improved use of technology systems, geographic diversity (that is, not being dependent on the economic strength of one market or region), greater consumer recognition and trust, and greater ability to explore new business prospects and provide growth opportunities to key team members.

Since the remodeling industry is so diverse, with business segments and market niches that cover the full spectrum from full-service and design/build firms to specialty replacements and handyman services, there is no one-size-fits-all approach to achieving scale. The remodeling companies successful in establishing a larger-scale presence in the remodeling industry have more typically been specialty replacement companies using strategies outside of organic expansion and acquisition. Instead, remodeling companies are more often finding success overcoming obstacles to scale by pursuing strategic alliances with manufacturers and distributors, private equity investors, or franchisors. In fact, it is telling that up to now the only companies able to provide home improvement services on a national scale—that is, serving most or all major markets across the nation—have been franchisors, manufacturers and distributors (including third-party installation services companies), and companies sold to or backed by private equity investors.

Many scaling strategies, such as franchising or licensing, strategic alliances, or manufacturer and distributor installed sales or certified contractor programs, are providing additional business to already well-established remodeling contracting businesses. For remodeling contractors expanding to new markets, building name recognition and brand awareness takes a significant investment of time and money, so partnering with a nationally-known and trusted franchise, manufacturing, or retail brand is highly effective for gaining direct

entry into a market with instant name recognition and credibility with consumers. This is a major benefit of such alliances, because most consumers will choose the brands they are already familiar with given the same quality and price. Strategic alliances with national franchisors, retailers and manufacturers also provide a high volume of high quality leads to a contracting business, and thus an instant boost in business. While it is certainly possible to grow a remodeling company to multiple locations or a regional market reach through organic business expansion and acquisition, this strategy will inevitably be much slower and more expensive than partnering with and adopting already established and trusted national brands.

Another interesting finding from this research is that contractors of all sizes are benefiting from participating in peer networks, which can take many forms such as business associations, franchisee networks, or manufacturer preferred contractor programs. These networks are invaluable at every stage of scaling a business and provide ways for contractors to share best practices and innovative ideas for scaling, as well as an ability to benchmark to their peers in the industry. As one industry leader put it, participating in peer networks and business associations should be “mission critical” for any remodeling business, and might be the single biggest differentiator between successful and unsuccessful businesses in this industry. Certainly, participating in peer networks of one form or another should be included as part of a company’s broader strategy for pursuing scale economies.

Yet, even though remodeling companies are finding many benefits of scale and many have been successful achieving scale economies, there continue to be many hurdles to scaling and more widespread consolidation efforts in the residential remodeling industry. Low barriers to entry and underpricing are still among the greatest obstacles to scale, and will remain so for as long as consumers are willing to take chances on contractors that offer lower prices but cut corners. Much of the industry still does not have strong business acumen; lack of sophistication in finance and valuation of companies limits prospects for consolidation because owner/operators tend to overvalue their companies and are not willing to do deals. There are also still plenty of small and mid-size companies that have no interest in scaling up, because they are successful, profitable, and comfortable at their current size and do not want the hassle of operating a multi-location or multi-regional business. Especially when business is good, it is

difficult for contractors to see why they should do anything differently about their business operations or strategy.

So what can be said about the future prospects for ongoing scaling and consolidation efforts in the residential remodeling industry? How will structure of this industry likely continue to evolve over the next couple decades? Are there relevant lessons from other related or similarly structured industries that might inform future scaling and consolidation efforts? Are there other strategies that have not been tried yet but might be pursued in the future?

The remodeling industry will likely always include some amount of fragmentation due to low barriers to entry and other challenges to scale facing the industry. While the remodeling industry may never reach the same level of concentration as other related industries, perhaps the future will see continued scaling and consolidation of mid-size remodeling companies into large-scale companies. The size of the residential remodeling market is estimated at \$300 billion, and within such a large and fragmented market, there is opportunity for companies that are organized, differentiated, and focused on brand building to capture market share and build large-scale businesses. And with the successful establishment of more larger-scale businesses in the industry using sophisticated business practices, the low-cost-of-entry contractor may start to have difficulty securing quality clients.

The sections below identify and discuss several themes for current trends in, and future prospects for, ongoing scaling and consolidation efforts in the residential remodeling industry.

1. The specialty trades or replacement segment of the industry is much more conducive to scaling than full-service contracting

Specialty remodeling companies have generally been more effective at achieving larger-scale businesses than full-service companies. Specialization allows firms to develop greater efficiencies in their operations and obtain more favorable pricing on materials compared to full-service remodeling firms. Specialty replacement projects also tend to be relatively straightforward, and so are less labor-intensive for scheduling and installation, which means shorter job cycles and consequently higher margins compared to design/build projects. Specialty firms have been pursuing scale in the remodeling industry by focusing heavily on

corporate sales and marketing strategies, and by integrating vertically. Again and again, large-scale specialty replacement firms interviewed for this project acknowledged that they operated their businesses much more like a marketing company than a traditional remodeling contractor, which usually emphasizes craft first and foremost. These specialty firms suggested that with their intense focus on lead generation, sales, and marketing they could be successful selling any type of product or service in any industry, because the standardized sales and marketing processes and principals could just as easily be applied to other lines of business.

Specialty replacement companies are much more likely to be vertically integrated with manufacturing of their core product lines such as windows, siding, or roofing. Vertical integration is beneficial for controlling the manufacturing process of exclusive products, guaranteeing quality and supply volumes, controlling materials costs, and minimizing the time between customer ordering and installation. In this way, vertical integration gives established large-scale companies substantial competitive advantages, thereby discouraging new competition. Being closely integrated and aligned with manufacturing and distribution business models provides remodeling companies with additional infrastructure, business processes, and human resources, all of which adds significant value to the company and thus puts it in a stronger position for outside investment, mergers, or acquisitions.

Significant scaling in the full-service segment of the industry will likely only occur if the consumer's process for selecting home improvement products and services can be simplified, requiring fewer choices. To do so, the industry will need to move toward selling home improvement projects as packages, with limited but high-quality options, and companies will need to figure out how to continue to inspire consumers with such packages. Analogies can be found in the auto industry, which typically sells automobiles with package options so consumers do not need to make choices about every detail of the automobile. For all of these reasons, it is much more likely that the industry will continue to see greater consolidation in the specialty trades or replacement segment of the industry than in the full-service segment.

2. Manufacturers and distributors have opportunities to play greater roles in supporting continued specialization, scaling, and consolidation of the industry

Manufacturers and distributors, including retailers, have the greatest motivation and investment capabilities for influencing scaling and consolidation in the industry through installed sales and contractor programs. In particular, manufacturers have a vested interest in scaling and consolidation because of the efficiency gains from a more streamlined supply chain, and they are already examining how they can be more effective in the remodeling market. Manufacturers and big box retailers will surely continue to leverage their national brand recognition and trust to further expand installation services for their customers, though it is still unclear whether they will move further into the installation services through in-house expansion or through the acquisition of already established, larger-scale contractor companies. Either way, manufacturers and distributors will likely be a formidable force behind ongoing consolidation in the remodeling industry.

Through certified or preferred contractor programs, there is an opportunity for manufacturers and distributors to continue to leverage their size and resources to help small and mid-size contractors improve their operations, build brand and inspire consumers. Indeed, both smaller- and larger-scale remodeling contractors have reported significant benefits from these contractor programs, which increase scale and market share. Such programs offer smaller-scale businesses substantial training, education and resources for business development, including: lead referrals and management; marketing strategies and materials; software and technology tools for website design and hosting, project design and management, quoting, and sales tracking; consumer financing relationships; and customer satisfaction surveys. Manufacturer and distributor programs are also pushing industry standards by requiring licensing, insurance, minimum years in business, financial and criminal background checks, good business practices, and customer follow-up and satisfaction. Larger-scale remodelers may not require as much business development assistance, but still benefit from preferred or certified contractor status as a distinguishing feature in their local markets, as well as any warranties offered by manufacturers that cover materials and installation.

3. Franchising, licensing and related business agreement efforts have been particularly successful in achieving a national footprint for specialty businesses, and will likely continue to be a promising model for consolidating the industry

Franchising, licensing, and similar agreements are well established scaling strategies in many similarly fragmented industries that allow a business to quickly expand its brand recognition and market reach without investing significant capital in building or acquiring new locations, and without having to manage each independently-owned and operated franchise, dealer or affiliate location. Franchisors and the like offer already established remodeling companies the opportunity to grow their business faster and more predictably through the proven, replicable business model and support of a franchise company. Through such agreements, franchisee companies often gain a recognized brand name, proven business systems, ongoing training and marketing support, and access to a peer network of franchisees for best practices advice and support. In these ways, a franchising or related strategy is mutually beneficial for both the principal company granting rights of use of product and systems and for the independent companies operating under such agreements. Overall, franchising and related efforts in the remodeling industry tend to be more successful with specialty businesses, such as painting, windows, bath liners, siding, and insurance restoration services, all of which are easier to standardize and streamline than full-service remodeling companies. Specialty firms emphasize the importance of strong management, sales and marketing skills for achieving scale, since installation is relatively simple and systematic.

4. Significant scaling opportunities lie in better leveraging client base relationships to create more interactions and potential for ongoing revenue opportunities that will help manage the volatile business cycles in this industry

Better leveraging relationships with a company's client base to create opportunities for repeat and referral business presents a big opportunity for scaling in the remodeling industry, and is a good strategy for dealing with its inherent cyclicity. Repeat business can be difficult to secure, however, especially for single-line specialty contractors installing high-quality home improvement products that might also offer lifetime guarantees. In this case, remodeling

companies can incorporate complementary product lines or services into the business, including broader home and lifestyle services. These strategies are easier when adding single specialty products or services that tend to have lower costs of installation or provision, as opposed to more complicated full-service activities, such as kitchen and bath remodeling, which involve juggling considerably more moving parts in terms of additional field supervision, crews, inspections, and scheduling. However, successful full-service remodeling companies might find that expanding into handyman services is a good way to start relationships with more consumers, who might then become repeat customers when looking to do bigger projects in the future.

Another possibility for leveraging the client base is through recurring revenue models for routine home services, such as ongoing maintenance of plumbing and HVAC systems, pools and spas, gutter cleaning, or power washing. David Lupberger, longtime industry consultant, speaker, author, and advocate, refers to this concept as the client-for-life business approach, and believes this is the future of the industry; he argues that contractors should take a more proactive role with homeowners to develop annual home evaluations and plans for routine or seasonal maintenance and repair work, as well as for future renovation projects.<sup>8</sup> In this way, Lupberger suggests, remodelers can foster loyalty from homeowners and become their “family contractor,” much like the family doctor or dentist; such stable relationships should help move homeowners past cost as their main consideration when hiring a contractor. If so, this client-for-life approach would combat the obstacles to scale presented by low barriers to entry and underpricing.

In all cases, the ability of contractors to offer competitive consumer financing will become an increasingly critical component of new business development and growth in the remodeling industry. More and more consumers are likely to demand financing options, since it allows for regular, smaller monthly payments for improvement projects. It also offers the opportunity for remodeling companies to engage consumers in larger-scale remodeling projects than they could otherwise afford if financing were not available to their clients.

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<sup>8</sup> Lupberger, David. January 2013. *Positioning for the Recovery*. Professional Remodeler.

5. Branding and customer experience and satisfaction will likely be a major factor in moving remodeling companies from the regional to national level

Building a trusted and recognizable brand on a national scale for which consumers would pay a premium, such as with franchising or strategic alliances, would likely transcend many of the other obstacles to scaling in the remodeling industry. Yet building a brand across many markets is very difficult, time-consuming and expensive. Oftentimes, remodeling companies are finding that a much more efficient strategy is to “rent a brand” from national manufacturers or retailers through strategic agreements or other arrangements. Companies that are building their brand more organically need to be cautious of scaling too quickly and losing the brand’s personality in the process, since remodeling is fundamentally a relationship-driven industry. In the end, remodeling is all about consumer experience, and branding is essentially based on consumer experience. Industry leaders report that larger-scale specialty contractors seem to be on the cusp of shifting towards a greater focus on consumer experience, in order to differentiate their business. Such a shift is important in light of changing consumer profiles, which show that clients are now better educated, have greater access to information, have many more options available for home improvements, and are more resistant to the high pressured sales pitches of yesteryear. A new converging of design/build elements and services with specialty contractors is starting to happen so that specialty firms can offer these bigger design/build services to consumers, but still keep processes more streamlined than a traditional design/build project.

The important connections between scale and branding can be seen in the example of the U.S. homebuilding industry. According to a recent study of the performance and operation of homebuilders during a period of immense consolidation and growth, large national homebuilders were able to leverage their scale especially favorably in terms of access to capital markets, aggressive land assembly, and corporate branding and customer satisfaction.<sup>9</sup> Large-scale homebuilders were better able to provide a consistent, positive customer experience across many markets, and scale thus contributed to stronger profits and growth for these

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<sup>9</sup> Abernathy, Frederick, Kermit Baker, Kent Colton and David Weil. 2012. *Bigger Isn't Necessarily Better: Lessons from the Harvard Home Builder Study*. Lanham, Maryland: Lexington Books.

builders. Remodeling companies will likewise need to convince consumers of the benefits of doing business with a larger-scale company.

6. Mastering labor development and talent acquisition will be key for successful scaling

Given the fragmented nature of the remodeling industry, there exists a relatively small labor pool from which to hire candidates who already have experience working in large-scale remodeling companies. This makes the training and development of employees especially critical for business expansion and longevity. Remodeling companies must invest in comprehensive employee development programs to train entry-level employees in company-specific systems and culture, and later to become managers and leaders within the company. By fostering a team of talented employees and a deep bench of skilled managers and leaders through rigorous training and mentorship opportunities, remodeling firms become much less reliant on founders for successful operation and expansion of the business. Less reliance on key operators also increases the stability and value of the enterprise.

7. Technology has been a revolutionary force in other industries and marketplaces, and the same is occurring in the remodeling industry

Technology will make scaling easier and be crucial to further consolidation efforts, with companies finding clever ways to leverage technology to achieve scale. Technology has already affected how clients are researching, selecting, and purchasing home improvement products and services; online reviews, for example, are important to the reputations of remodeling companies and products. Technology will continue to be transformative in numerous areas, including: sales, marketing and social media, tracking client behavior and purchasing, managing consumer reviews, acquiring talent, replicating business systems, controlling ordering and inventory, and producing a more consistent experience for customers. Again, major franchisors and manufacturers and distributors are likely to play an important role in providing innovative technologies in such areas to remodeling contractors of all sizes.

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## **Appendix A: List of Persons Interviewed**

(with position and affiliation at time of interview)

**Jim Barreira**, Executive Vice President, Harvey Building Products

**Michael Bettencourt**, Co-Owner, Innovative Contracting Services and James Hardie Preferred Remodeler

**David Bradley**, Owner, All in One Contracting and James Hardie Preferred Remodeler

**Emily Cavanagh**, Executive Director of Shingles and New Product Development, GAF

**Jeff Caveney**, Director of Retrofit, Masco Contractor Services

**Dave Cerrone**, Owner, Fitch Construction and VELUX 5-Star Specialist

**Charlie Chase**, President and CEO, FirstService Brands

**Emanuel Coelho**, Co-Owner, Innovative Contracting Services and James Hardie Preferred Remodeler

**Nick Cogliani**, Founder and Owner, NEWPRO

**Chris Dana**, Trade Marketing Manager, Pella Corporation

**Paul Deffenbaugh**, Editorial Director, Modern Trade Communications, Inc.

**Paul Delahunt**, President, Renewal by Andersen

**Chris Edelen**, President and CEO, LeafGuard by Beldon

**Gary Ford**, Director of Technology and Brand Management, RF Installations

**Larry Green**, CEO & Co-Founder, System Pavers

**Murray Gross**, CEO and Chairman, US Home Systems

**Rick Grossberg**, Founder, Remodelers Guild

**Todd Hall**, General Manager Builder Marketing, Owens Corning Basements

**Tom Kelly**, President, Neil Kelly

**Andrew Kiefer**, Senior Vice President of Business Development, The Home Service Store, Inc.

**Larry Laseter**, Senior Vice President Marketing, Masco Contractor Services

**Rob Levin**, President, Statewide Remodeling

**David Lupberger**, David Lupberger and Associates, LLC.

**Larry Meadows**, CEO, American Exteriors

**Joe Moorman**, CFO, Solar Lighting of Virginia and VELUX 5-Star Specialist

**Stephan Moyon**, Director of Sales, VELUX America

**Kevin O’Neill**, General Manager, Wellborn Cabinet Inc.

**Bill Owens**, President, Owens Construction

**Asher Raphael**, CSO, Power Home Remodeling Group

**Matt Sampson**, Vice President of Marketing, Harvey Building Products

**Tom Seibert**, Director of Remodeling and Strategic Sourcing, Paul Davis Restoration

**Marc Setty**, Marketing Manager, James Hardie Building Products

**Jeffrey Shawd**, Vice President Marketing - Home Improvement Division, GE Capital

**Peg Sirolli**, Co-Owner, Ron Sirolli Construction Co. Inc. and Wellborn Cabinet Authorized Contractor

**Craig Thorslund**, Owner, Sun Up Construction and VELUX 5-Star Specialist

**Michael Turner**, Vice President, The Home Service Store, Inc.

**Rich Wilson**, President, CertaPro Painters

## **Appendix B: Interviewed Company Profiles**

### **1. Remodeling Contractors**

*Unless otherwise noted, figures are for 2012 as reported in Qualified Remodeler magazine's 2013 Top 500 Remodelers list or Remodeling magazine's 2013 Remodeling 550 list. Reported revenue is for remodeling gross sales, number of jobs is for remodeling jobs and number of employees does not include subcontracted labor. Figures are rounded. Information on areas served was provided from interviews and websites.*

#### **American Exteriors, LLC**

*Business Type:* Specialty; replacement windows, siding and roofing.

*Headquarters:* Littleton, CO

*Years in Business:* 28

*Revenue:* \$29 million

*Number of Jobs:* 3,800

*Number of Employees:* 290

*Areas Served:* Nine locations operating in 13 states across the Midwest and Mountain regions.

#### **The Home Service Store, Inc.**

(Information provided by company for 2013)

*Business Type:* Specialty; replacement flooring, windows, siding, insulation and more.

*Headquarters:* Kennesaw, GA

*Years in Business:* 15

*Revenue:* NA

*Number of Jobs:* 60,000

*Number of Employees:* NA

*Installer Network:* 700

*Areas Served:* Operating in 42 states nationwide.

#### **LeafGuard by Beldon**

(Information provided by company for 2013)

*Business Type:* Specialty; replacement gutters.

*Headquarters:* San Antonio, TX

*Years in Business:* 67

*Revenue:* \$65 million  
*Number of Jobs:* 10,000  
*Number of Employees:* NA  
*Areas Served:* Sixteen locations in 12 states, Washington, DC metro and Vancouver, BC.

**Neil Kelly**

*Business Type:* Design/Build  
*Headquarters:* Portland, OR  
*Years in Business:* 66  
*Revenue:* \$18 million  
*Number of Jobs:* 1,000  
*Number of Employees:* 155  
*Areas Served:* Five locations in Pacific Northwest.

**NEWPRO**

*Business Type:* Specialty; replacement windows, siding, roofing and bath liners.  
*Headquarters:* Woburn, MA  
*Years in Business:* 35  
*Revenue:* \$13 million  
*Number of Jobs:* 1,400  
*Number of Employees:* NA  
*Areas Served:* New England

**Power Home Remodeling Group**

(Information provided by company for 2013)

*Business Type:* Specialty: replacement windows, siding, roofing, gutters, doors and insulation.  
*Headquarters:* Chester, PA  
*Years in Business:* 22  
*Revenue:* \$245 million  
*Number of Jobs:* 150,000  
*Number of Employees:* 1,350  
*Areas Served:* Eight locations serving thirteen states in Northeast, South and Midwest regions.

**RF Installations, LLC**

*Business Type:* Specialty; replacement doors, windows, siding, kitchen cabinets and more.

*Headquarters:* Grand Prairie, TX

*Years in Business:* 7

*Revenue:* \$37 million

*Number of Jobs:* 122,000

*Number of Employees:* 50

*Installer Network:* 1,500+

*Areas Served:* Operating in 40 states nationwide, including most major metro areas.

### **Statewide Remodeling**

(Information provided in interview for 2013)

*Business Type:* Full-Service

*Headquarters:* DFW Airport, TX

*Years in Business:* 19

*Revenue:* \$40 million

*Number of Jobs:* 3,000

*Number of Employees:* 100

*Areas Served:* Five locations across Texas.

### **System Pavers**

(Information provided in interview for 2013)

*Business Type:* Specialty; hardscape paving and outdoor living systems.

*Headquarters:* Santa Ana, CA

*Years in Business:* 21

*Revenue:* \$67 million

*Number of Jobs:* 4,500-5,000

*Number of Employees:* NA

*Areas Served:* Nine locations in California and Pacific Northwest.

### **U.S. Home Systems, Inc.**

(Data are from 2011 prior to purchase by The Home Depot)

*Business Type:* Specialty; kitchen and bath cabinet re-facing

*Headquarters:* Irving, TX

*Years in Business:* 15

*Revenue:* \$165 million

*Number of Jobs:* 25,000

*Number of Employees:* 1,000

*Areas Served:* Presence in Home Depot stores in 69 markets covering 37 states.

## **2. Manufacturers & Distributors**

*Information is specific to installed sales and contractor programs operating within the broader company and was provided from interviews and websites. Information listed is intended to provide program highlights only.*

### ***Installed Sales:***

#### **Masco Contractor Services®**

*Business Type:* Installed sales of insulation, gutters, fireplaces, garage doors, closet shelving and storage systems, and shower enclosures.

*Years in Business:* 12

*Business Model:* Owned subsidiaries

*Areas Served:* 190 locations in most major metropolitan markets across the nation.

#### **Owens Corning® Basement Finishing System™**

*Business Type:* Specialty franchisor of basement finishing system.

*Years in Business:* 13

*Business Model:* Franchises

*Areas Served:* Nine locations serving markets across Midwest, Northeast and mid-South regions.

#### **Renewal by Andersen®**

*Business Type:* Installed sales of window and door replacements

*Years in Business:* 18

*Business Model:* Affiliate dealer agreements

*Areas Served:* Over 100 markets across the nation.

### ***Contractor Programs:***

#### **GAF**

*Business Type:* Roofing materials manufacturer

*Program:* Certified Contractor

*Years:* 17

*Benefits:* Generate quality leads, reinforce trust, close more sales, reduce costs, and increase capabilities.

*Additional Features:* Enhanced warranties covering materials and workmanship. Center for Advancement of Roofing Excellence (CARE) dedicated to the education of contractors on proper roofing installation techniques and business development.

*Requirements:* Proof of workman's compensation and liability insurance, good standing with the Better Business Bureau (BBB), minimum three to five years in business, good credit rating with primary distributor, pass pro field guide certification test on good roofing practices, and take in-person CARE training sessions.

*Typical Contractor Characteristics:* Smaller-scale exterior replacement businesses focusing on roofing, siding and windows serving a limited market area with annual revenues under \$5 million.

### **Harvey Building Products**

*Business Type:* Building products manufacturer and distributor

*Program:* Contractor Referral

*Years:* 12

*Benefits:* Generate quality leads by matching interested homeowners with experienced professionals; access to secure, interactive website where contractors can provide a profile or company statement and list certifications and homeowners can provide feedback reporting through surveys; and off-the-shelf customizable marketing materials including mailers and mailing lists, brochures, print ads, door hangers, job signs, apparel, business cards, web tools and more.

*Requirements:* Minimum sales criteria and experience with Harvey building products.

### **James Hardie**

*Business Type:* Fiber cement building products and systems manufacturer

*Program:* Preferred Remodeler

*Years:* 12

*Benefits:* Build credibility and trust, generate quality leads, close more sales, training and development. Company endorsement on JamesHardie.com; extensive business building tools including website lead generation; trainings on service, installation and best practices; sales and marketing support; and access to advanced lead tracking and customer satisfaction surveying systems.

*Requirements:* Extensive vetting process including background checks and job auditing, minimum two years in business, satisfactory record with the BBB, state

licensed and fully bonded where required by law, proof of workman's compensation and liability insurance, must derive a high share of overall revenue from selling James Hardie® siding products and fully commit to the James Hardie brand and product portfolio.

*Typical Contractor Characteristics:* Established, professional contractors specializing in exterior replacements.

### **Pella Corporation**

*Business Type:* Window and door manufacturer

*Program:* Certified Contractor

*Years:* 10

*Benefits:* Market distinction; training and certification in installation; training in sales, best business practices, and customer satisfaction; access to online quoting software; marketing and sales tools and merchandise; preferred pricing; and rewards program.

*Requirements:* Minimum sales criteria.

*Typical Contractor Characteristics:* Over half are exterior replacement contractors with balance being full-service and design/build contractors.

### **VELUX America Inc.**

*Business Type:* Skylight and roof windows manufacturer

*Program:* 5-Star Skylight Specialist

*Years:* 7

*Benefits:* Generate quality leads, training in installation, business and marketing support, lead management, customizable advertising and marketing materials.

*Requirements:* Dedicate business to specializing in skylight installation or create separate division dedicated to skylights.

### **Wellborn Cabinet Inc.**

*Business Type:* Kitchen and bath cabinetry and closet storage manufacturer

*Program:* Authorized Contractor

*Years:* 5

*Benefits:* Trainings and assistance with business technology, project management, marketing tools and strategies, and a facilitated partnership with qualified kitchen and bath dealers for showroom and design services.

*Requirements:* Professional, established contractors, minimum years in business, licensed and insured.

*Typical Contractor Characteristics:* Majority are full-service contractors wanting to specialize in kitchen and bath with average revenues of \$750,000.

### **3. Franchisors**

*Figures are for 2012 and rounded. Information was provided from interviews, websites, and Remodeling magazine's 2013 Remodeling 550 list.*

#### **CertaPro Painters**

(Owned by FirstService Brands)

*Business Type:* Specialty franchisor in residential and commercial painting.

*Headquarters:* Oaks, PA

*Years in Business:* 24

*Revenue:* \$265 million

*Areas Served:* 440 locations in over 40 states, including all major metros in US, and most Canadian provinces.

#### **FirstService Brands**

*Business Type:* Franchisor of property services.

*Headquarters:* Radnor, PA

*Years in Business:* 24

*Brands:* BrandPoint Services, California Closets, CertaPro Painters, College Pro Painters, Floor Coverings International, Paul Davis Restoration, Pillar To Post Home Inspection, Service America and TLS.

*Revenue:* \$1.25 billion

*Areas Served:* North America

#### **Paul Davis Restoration**

(Sold to FirstService Brands in 1997)

*Business Type:* Specialty franchisor in insurance restoration.

*Headquarters:* Jacksonville, FL

*Years in Business:* 47

*Revenue:* NA

*Areas Served:* 300 locations in 47 states.