



HOME SWEET HOME

PROS' EDITION

MAY 2017

INDEPENDENT WE STAND™



POWERED BY **STIHL**



NRHA

North American Retail
Hardware Association



INTRODUCTION

Civic Economics is pleased to present Independent We Stand and the North American Retail Hardware Association with this, a second analysis of the economic impact of supporting independent building supply, hardware, power equipment, and paint dealers in support of the construction industry.

In 2015, our organizations collaborated on the groundbreaking *Home Sweet Home* study, which quantified the enhanced impacts associated with a homeowner using independent, locally-owned suppliers to complete a modest home improvement project. In this iteration, dubbed the Pros' Edition, we expand that analysis to the scale of a sizeable home constructed by a professional building contractor.

This report builds on Civic Economics' extensive analyses comparing the local economic impact of conducting business through a locally-owned independent business (or businesses) or through a major national chain. (See CivicEconomics.com/retail for summaries and downloads). While these studies have looked at various lines of goods and services in several American and Canadian communities, the essential findings are broadly consistent:

Independent businesses provide their communities with substantial, quantifiable economic benefits relative to their chain competitors, and modest changes in purchasing habits can produce meaningful impacts.

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In 2015, Civic Economics partnered with the National Retail Hardware Association and Independent We Stand to produce *Home Sweet Home*, applying this analytical approach to the hardware and building materials sector. In that case, we found that purchases of tangible goods from independents produced roughly double the local economic impact compared to national chains.

For 2017, we have expanded the approach of Home Sweet Home to consider the choices facing professional contractors engaged in bigger projects.

Home Sweet Home: Pros' Edition presents us with an opportunity to reach out to an important audience for the independent business message. Through the years, Civic Economics has emphasized that supporting local business provides a clear return to a few sectors in a community that thrive only when the local economy thrives. Think, for example, of a locally based hospital: a stronger local economy yields more paying patients, which leads directly to a stronger hospital. Conversely, a weakening local economy, with weak locally-owned businesses, deprives the hospital of the healthy, paying clientele it requires to thrive.

The same applies to contractors. Clients for million dollar homes do not grow on trees from which homes are built, nor does the housing market absorb them. Rather, they are the product of a healthy, dynamic economy that produces demand for custom homes and inspires the confidence to commission them. This study demonstrates that directing purchasing through locally-owned, independent businesses produces substantial impact in the local market, the same market our contractor and subcontractors depend upon for their livelihood.

HYPOTHETICAL PROJECT APPROACH

Hardware and building supplies are a complex retail business sector. Within the same business, there may be a hardware store with everything from nuts and bolts to bolts of fabric. There may be a lumberyard, with racks of building materials ready for loading onto trucks of all sizes. There may be a power equipment department, offering bigger ticket items and, often, repairs. Finally, the merchant may provide customers with installation services after the sale. Many include indoor and outdoor garden centers, as well. In some cases, all these goods and services are offered under one roof.

These varied departments may function as a single business, but the business model is different for each. Building material sales, for example, are less labor intensive than hardware sales. Developing a hypothetical building project allows us to allocate spending across lines of goods and merchant types and follow those dollars into the economy. For the previous study in 2015, Civic Economics developed a hypothetical home remodeling project in order to compare the purchasing choices facing a typical homeowner. That project, with a budget of \$10,000, included \$7,000 of tangible goods purchases.

For this, the Contractor Edition of Home Sweet Home, we have formulated a larger project for which a professional contractor will be engaged.

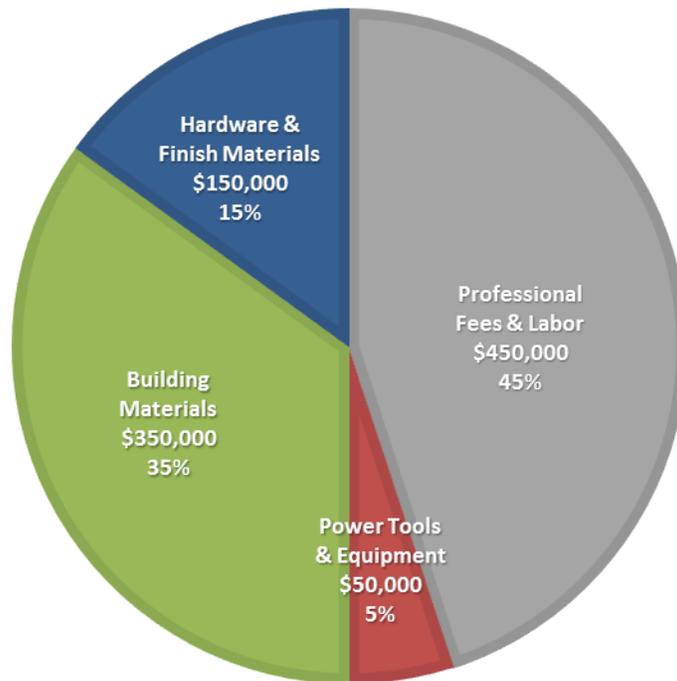
Project Description

Our hypothetical for this study is the construction of a single-family home with a total budget of \$1 million. Of that, roughly 45% is allocated to fees and labor while the remaining budget is split among the various retail sectors described in the following section:

- \$350,000 (35% of the budget) will be spent in the building materials sector;
- \$150,000 (15% of the budget) will be spent in the hardware sector; and
- \$50,000 (5%) will be allocated to power tools and equipment that may be used on multiple jobs.

The client is assumed to retain the services of a local, professional building contractor, who will oversee all aspects of the project and select subcontractors and suppliers as needed.

PROJECT COST ALLOCATION (\$1 MILLION)



Merchant Types

For this study, we identified three retail sectors that contractors and subcontractors might call upon for purchases, and studied the business practices and finances of both independent and chain merchants in each.

Retail Sectors

The first sector is *building materials suppliers* or lumber yards, which are defined as “outlets (that) capture the majority of their sales from lumber and building materials and typically have retail sales floors smaller than 10,000 square feet. This category will be used for the major purchases of building materials associated with a project of this size. These businesses typically look less like retail and more like distribution facilities. Deliveries often arrive and depart by flatbed, and they are typically located in isolated or light-industrial districts.

The second sector is *hardware stores*, which the NRHA defines as “stores (that) carry core lines of home repair, renovation and maintenance products, including fasteners, tools, plumbing and electrical supplies. They carry little or no lumber and building materials.” This category will be used to capture a range of purchases that will be made over the course of the project. These stores are recognizably retail, situated in commercial districts and designed to invite shoppers.

The third sector provides *power tools and equipment*. Typically treated as indirect overhead in construction budgets, this class of purchases includes tools and equipment contractors and subcontractors must purchase and maintain that are used across numerous jobs.

Independents and Chains

Within these retail sectors, contractors have two broad choices: locally-owned, independent suppliers or their national chain competitors. The items needed for this project will most likely be purchased at more than one nearby business. Most contractors operate within a short distance of a competitive mix of locally-owned, independent businesses and national chains offering some or all of the materials and supplies required for this project.

Independent retailers in these lines of goods may operate branded stores without being franchised. Within the hardware category, for example, there are competing merchant cooperatives that provide members with purchasing power as well as branding and advertising services. True cooperatives provide a periodic rebate to member stores rather than retaining profits. Similarly, independent lumber yards may participate in a purchasing cooperative or service and also support independent distributors.

How does the customer identify independents? Many independent stores do not carry a national brand. Do It Best, Ace, and True Value hardware stores operate on the cooperative model described above. Additionally, any outdoor power equipment dealer carrying Stihl products is an independent or cooperative.

For this exercise, the chain competition is primarily represented by the two largest, most easily identified home center chains, Lowe's and Home Depot. These big box stores offer hardware, power equipment, and building materials under one roof. Though the two chains may feature

different color schemes, they offer remarkably similar goods and services and they procure and distribute those goods in similar fashion.

Additionally, for this study we have added another national competitor to the mix. Builders Firstsource operates a 400-location chain of building material outlets under various names throughout the United States. Often these names may sound like they are independent locations (Kalamazoo Lumber or Tulsa Millwork, for example), reflecting the company's aggressive acquisition strategy through the years and, perhaps, a desire to appear local and independent.

Methodology

When updating this study the choice was made early on to maintain the same essential methodology we used in *Home Sweet Home*. However, there are some minor changes that will be detailed below, as we are constantly tweaking our approach as we learn more about the way local and chain businesses operate and discover new data sources for each.

As with the previous iteration of this report the analysis begins with the same four major activities in which firms provide local economic advantage by recirculating revenues in the local economy:

1. Labor
2. Profit
3. Procurement
4. Charitable Giving

In each of these activities and for each of the sectors and merchants analyzed, locally-owned merchants recirculate more of their revenue into the local economy than do their chain competitors.

Spending on local labor generally comprises a larger share of operating costs for a locally-owned establishment than for an outlet of a national chain. While the latter are able to consolidate administrative functions such as bookkeeping and marketing at national headquarters, independents must carry out those functions in-house or outsource within the community causing a larger percentage of sales to be assigned to salaries of employees living in that community rather than off in the headquarters' community. The difference is clear on the shop floor, too. Upon entering an independent store, a sales associate will often walk with you to the department and help you pick out the correct part and discuss alternatives and applications. At the chains, any assistance beyond directions to a row number may be hard to come by.

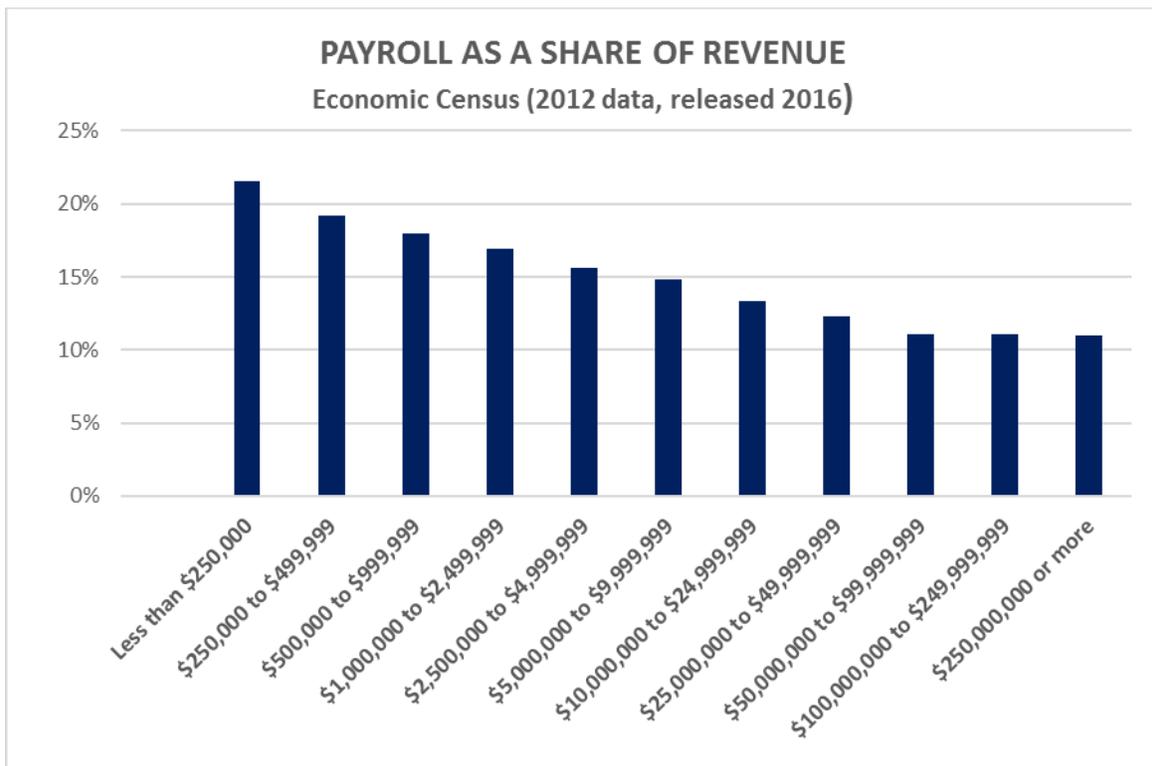
Secondly, a larger portion of profits earned by local ownership will remain in the local economy. These profits can be reinvested locally whether through further investment in the independent business or in the community at large. Purchases at chain outlets generate profits for the corporation, which then either reinvests in global operations or distributes a portion of profits to shareholders. In either case, chain stores profits returning to the local economy are nominal at best.

Third, locally-owned businesses procure services locally. An independent business will hire local accountants, lawyers, and information technology firms among others. For national chains, these services are provided at a corporate facility or outsourced to other firms that may be located anywhere in the world.

A smaller yet significant share of the local advantage is charitable giving. Local resident owners are more likely to contribute to local causes of interest to their families and employees. We have found many small businesses fail to account for charitable giving in full. National chains, by contrast, more often support non-local causes. And when they do support local organizations, the marketing campaign may exceed the value of any gift.

For independent businesses, Civic Economics surveys or interviews owners to quantify accurate numbers for the proportion of revenue that goes to each. In this study, interviews with business owners in the Chicago and Tulsa areas is supplemented by two invaluable sources. The North American Retail Hardware Association provided us with their 2016 Cost of Business Survey, which broke out costs and revenues in hardware and lumber sectors. Independent We Stand contacted Stihl, Inc. and provided an average dealer margin for the company's consumer grade power equipment. Civic Economics further estimated the local dealers likely revenue from warranty service and repairs associated with Stihl sales. To protect the company's proprietary information, we have here aggregated those two numbers and further discounted occupancy costs from the total.

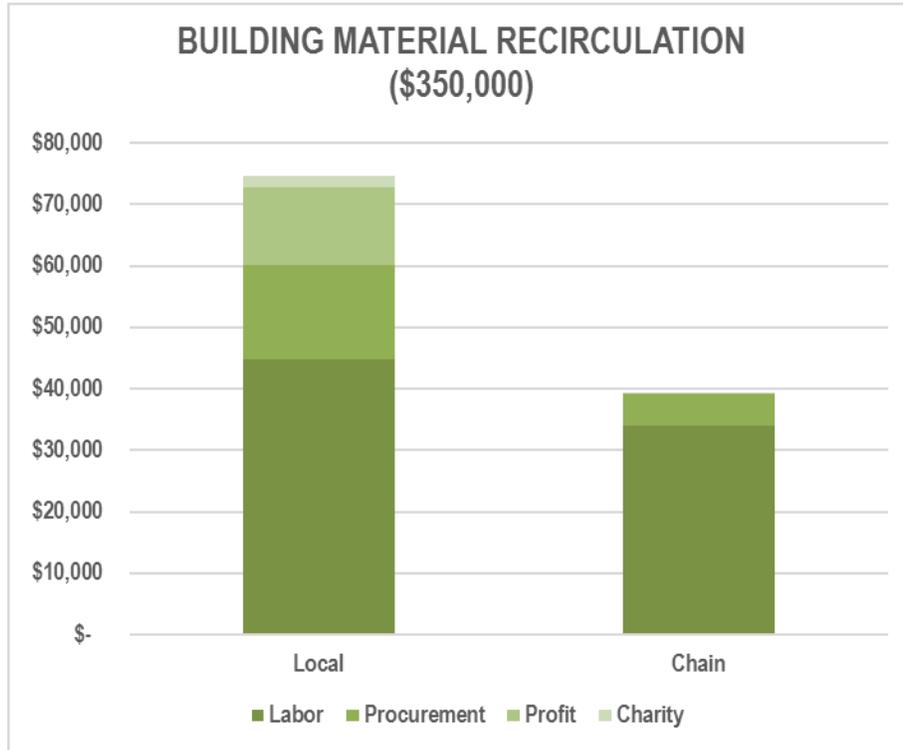
For chains, we analyzed Annual Reports, in this case for fiscal year 2016, for both Home Depot and Lowe's as well as Builders FirstSource. This information was compared to data provided in the 2012 Economic Census, which was released this past year. The Economic Census provided sales, employment, and wage data for all retail sectors in the United States that are further broken out by total sales of the firms. By using the largest firm size as determined by total sales (over \$250 million) we were able to determine wages as a percentage of sales revenue. The following chart shows how the percentage of sales dedicated to wages declines as the stores grow in size and provides the economic advantage to independent retailers in terms of keeping money in the local community.



QUANTIFYING LOCAL ADVANTAGES

For each portion of the project materials budget, Civic Economics analyzed the local recirculation of dollars associated with purchases from independent and chain merchants.

Building Supply Purchases

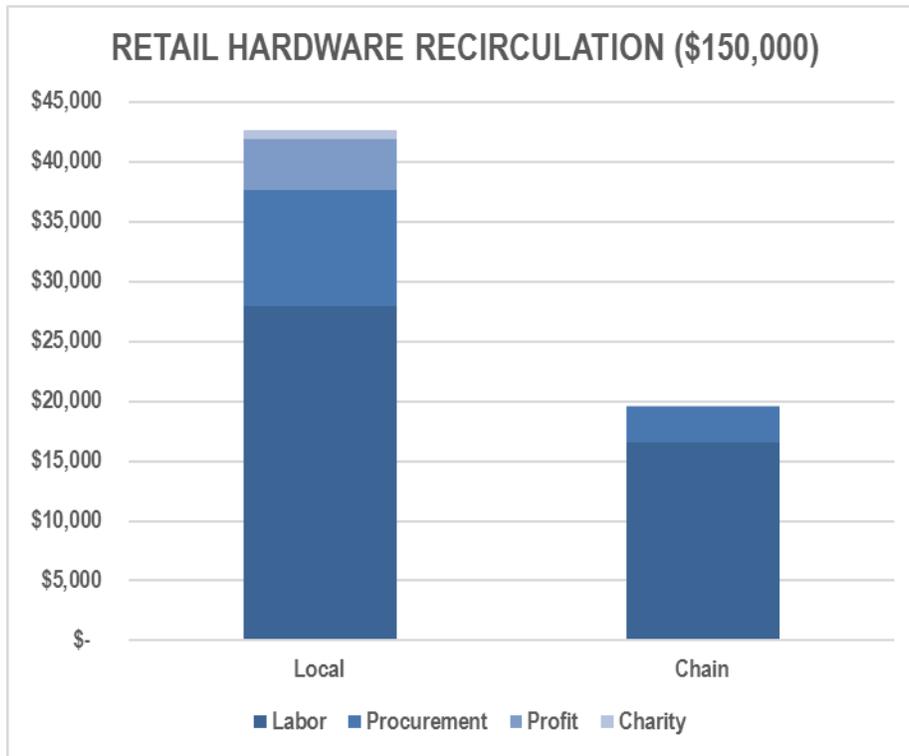


Our contractors will procure the bulk of project materials from building material suppliers. Armed with detailed construction plans, the contractor and the supplier will coordinate delivery of materials by the truckload. From the foundation to the chimneys, materials will arrive to feed an efficient construction schedule. In any sizeable market, independent suppliers are available to meet this need.

On the outskirts of Stillwater, Oklahoma, Civic Economics visited Stillwater Building Center, which serves developers with a full range of building materials sourced from within the region and far afield. In their community, the primary chain competition comes from Builders FirstSource, a national building materials supplier with outlets in nearby cities, though Lowe's and Home Depot certainly figure into the competitive landscape.

This analysis of the local recirculation of revenue is not based on any individual outlet, and the Building Center was not asked for financial details. On average, though, our analysis reveals that a typical independent recirculates nearly twice as much of its total revenue within the local market in the form of labor, profit, procurement, and charitable giving. In this sector, labor costs are not the largest driver of the difference, as both operate with efficiency. Instead, the distribution of profits to resident owners and the ability to procure materials from nearby suppliers drive the enhanced economic impact of independent building suppliers.

Hardware and Finish Purchases

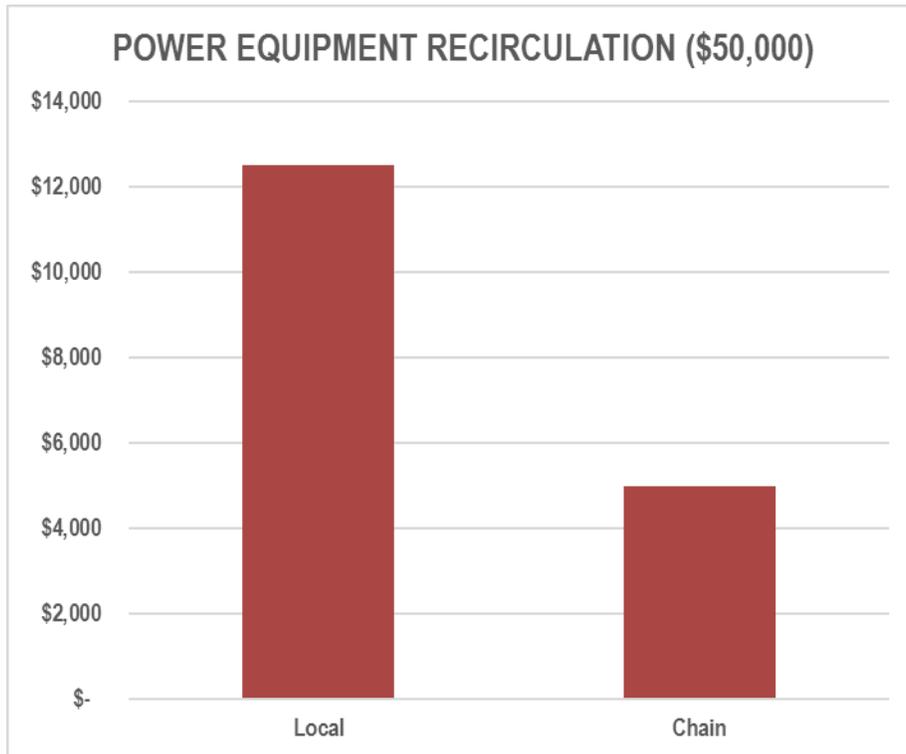


As the project proceeds, our contractor and subcontractors will purchase a vast array of goods in addition to those described above from the building materials supplier. Where concrete and bricks, lumber and sheetrock will be delivered to the site in bulk, every specialist on the site will need to procure additional materials necessary to the project. These purchases range from simple items like nails and screws and spackle to unusual items like millwork and plumbing fixtures that make our project special. For these purchases, they may visit a locally-owned, independent hardware store or a unit of one of the two dominant national chains.

Our analysis of this sector included a review of annual reports for Home Depot and Lowe’s, the most recent Cost of Business survey materials from the National Retail Hardware Association, and Civic Economics’ extensive database of individual retailer surveys.

The impact differential between independents and chains in the hardware is striking, with more than double the local recirculation of dollars at the independent. The local business is generally more labor-intensive than the chain, reflecting a focus on sales floor support and personnel available to identify and provide specialty items the chains might decline to carry. Locally distributed profits and procurement, as well as charitable giving, round out the substantial local economic impact of independent hardware stores.

Power Tools and Equipment Purchases

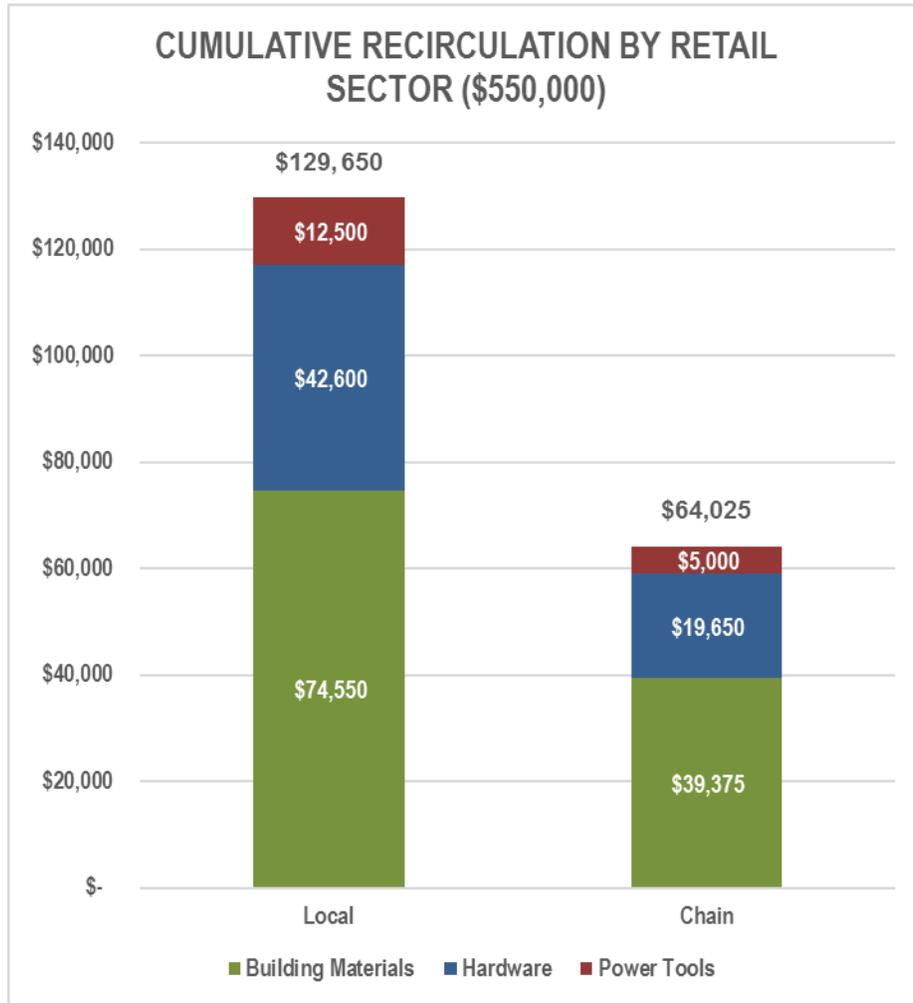


Power tools and equipment purchased by contractors are utilized on multiple projects, and the cost of these items are generally accounted for in contractor fees. For this study, focused as it is on independent merchants, we decided to isolate the proportion of this “indirect overhead” that includes power tools and equipment for further analysis. This estimate is based on 5% of total project cost.

We have compared the impact of purchasing from an average independent Stihl power equipment dealer versus doing so at a national chain home center. To gain a better understanding of the sector, Civic Economics visited Ralph Helm, Inc., a nearly 100-year-old family held merchant with three locations in the Chicago area. In addition, Independent We Stand provided data about margins and repair services among Stihl dealers, all of whom are locally-owned, independent businesses.

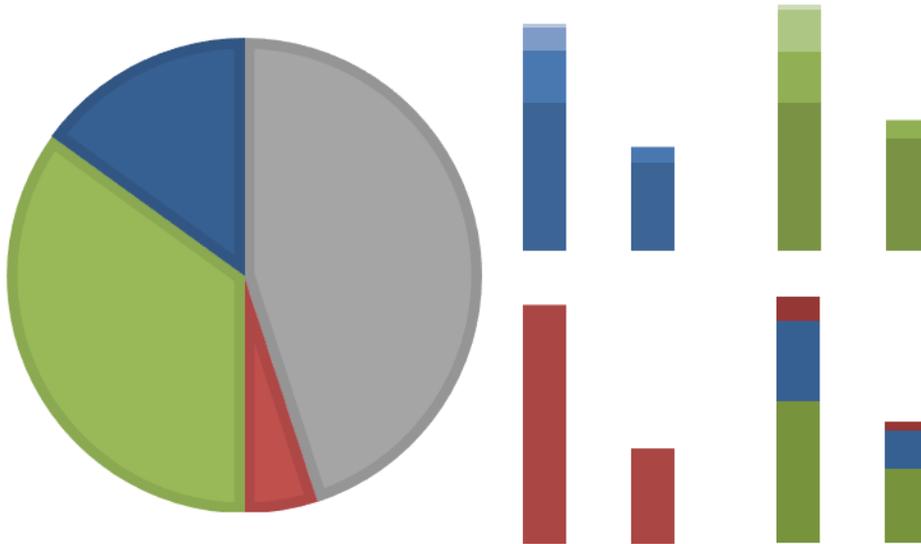
Based on this analysis, we estimate that independent power tool and equipment merchants recirculate 250% more local dollars than their chain competitors.

CUMULATIVE LOCAL ADVANTAGE



In this hypothetical project, a contractor will be retained to build a home with a total budget of \$1 million. Of that, our contractor and subcontractors will expend \$550,000 on building materials, hardware, and power equipment. For every purchase, they will face a choice: supporting a local supplier or turning to a national chain competitor.

Assuming competitive pricing in the market area, the value received will be comparable. Across all three sectors (building materials, hardware, and power equipment), those purchases will generate more than twice the local economic activity if made at the independents.



CONCLUSION

Civic Economics has a long history of studying the comparative economic impact advantages provided by independent, locally-owned merchants. Through nearly 15 years of studies and countless media appearances, these studies have made a tangible difference in the health of small business in those communities where “local first” has become part of the ethos.

In our previous work for IWS and the NRHA (*Home Sweet Home*, 2015), for example, we documented that even modest home improvement projects provide strong local impacts when goods and services are purchased from locally-owned, independent businesses. With every dollar spent on such a project, a homeowner can produce twice the local economic impact by supporting independents.

In this, the *Contractor Edition*, we find similar impact boosts when a builder procures necessary inputs from independent local suppliers. The contractor for our one hypothetical home, with \$550,000 in goods purchased, recirculates an additional \$65,000 in the local economy just by directing business other local business owners.

Nationwide in 2016, a total of \$243 billion was spent on single-family residential construction in the private sector. Extrapolating our hypothetical to that broader market, these projects collectively required \$133.7 billion in purchases of tangible goods. If contractors shifted just 10% of those purchases from national chain dealers to independent suppliers, hometowns around the nation would enjoy the benefits of an additional \$1.5 billion in economic activity.

Where local business thrives, the community benefits. Owners and employees invest in local homes in a way that chain store workers can rarely do; their profits feed little leagues and collection plates all over town; and the enhanced tax revenue they drive ensures that the community can provide the services those businesses and their customers require.

We always strive, though, to preach beyond the choir of engaged consumers willing and able to invest their time to understand the economics of their purchasing choices. This study addresses

an issue of great and growing importance in the movement for independent, locally-owned business: procurement by businesses from other businesses.

Just as with individual consumers, business owners face consequential choices in procurement. But more than most households, contractors are in a position to benefit from the virtuous cycle of local economic activity they themselves can kick start by supporting other locally-owned, independent businesses.

Our hypothetical client here is prosperous enough and confident enough in the community to erect a million-dollar home there, but that prosperity and confidence don't arise in a vacuum without a healthy business community. By supporting fellow local business owners, the contractor can feed the cycle that feeds his or her business.

We are grateful to the National Retail Hardware Association and Independent We Stand for identifying that opportunity, and look forward to sharing the message in the years to come.

ABOUT CIVIC ECONOMICS



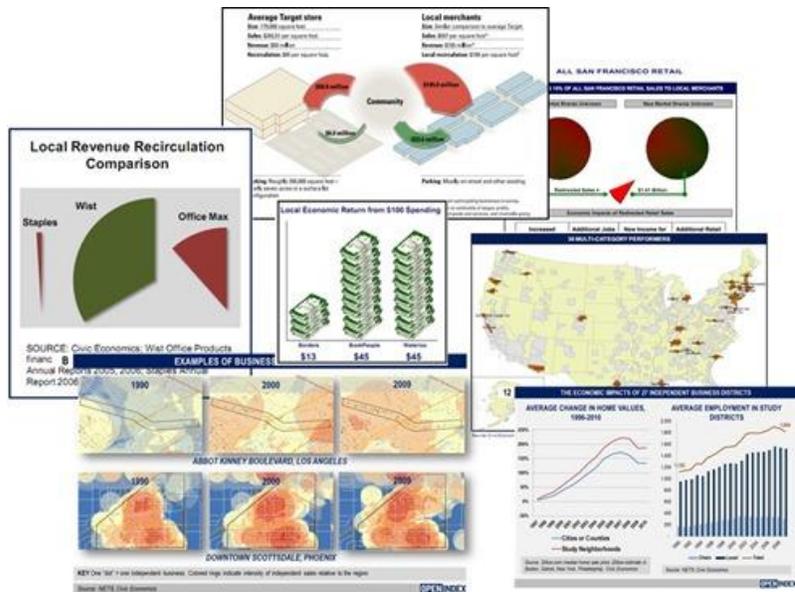
Civic Economics is an economic analysis and strategic planning consultancy with offices in Austin and Chicago. Since its founding in 2002, the work of Civic Economics has been nothing if not diverse, in both subject matter and geography. One area to which we frequently return, however, is the economics of regional retail and service provision - what we've taken to calling *the Civic Economics of Retail*.

Retail development and redevelopment bring significant impacts to any community. Civic Economics provides communities with the tools to manage those impacts, magnifying the benefits and mitigating the challenges.

Civic Economics is the acclaimed leader in understanding the economics of regional retail and service activities. From its founding, the firm has focused on the critical and often misunderstood role of retail in economic development and urban planning policy.

Civic Economics analyzes the economics of retail and service provision using time-tested, industry standard approaches tailored to the needs and circumstances of each community. These include trade area analysis, demographic analysis, consumer and business surveys, retail prospect identification, retail gap analysis, adaptive reuse of mature retail centers, and economic and fiscal impact analysis.

More importantly, the partners of Civic Economics monitor the ever-evolving retail industry. We know where market forces are heading and what retailers are doing in response. We know, too, what other communities are doing, providing us with an unmatched knowledge of best and worst practices. In contrast to our larger, convention-bound peers and academic researchers, Civic Economics has developed innovative methodologies for analyzing this unique industry sector.



Learn more at: CivicEconomics.com

CONTACTS

To learn more about this study and the organizations behind it, contact the individuals below.

FOR INDEPENDENT WE STAND

Bill Brunelle
888-787-8497
bill@independentwestand.org
IndependentWeStand.org



FOR THE NORTH AMERICAN RETAIL HARDWARE ASSOCIATION

Dan Tratensek
317- 275-9407
DanT@nrha.org
NRHA.org



FOR CIVIC ECONOMICS

Matt Cunningham
773-251-5926
mattc@civiceconomics.com
CivicEconomics.com

